PAINTED PONY PETROLEUM LTD.

2008 ANNUAL REPORT TO SHAREHOLDERS

A STEADY CLIMB

Corporate Profile

Painted Pony Petroleum Ltd is a public junior oil and gas exploration company based in Calgary, Alberta, Canada. The Company closed its initial public offering and commenced trading on the TSX Venture Exchange in May 2007. Painted Pony's corporate philosophy is to grow through exploration and development drilling complemented by both corporate and asset acquisitions. The Company's long term target is to maintain a balanced crude oil and natural gas emphasis in resource-type plays.

ANNUAL GENERAL AND SPECIAL MEETING

Painted Pony Petroleum Ltd. invites shareholders and interested parties to attend its Annual General and Special Meeting to be held at the Viking Room at the Calgary Petroleum Club, 319 - 5th Avenue S.W., Calgary, Alberta on Wednesday, June 3rd, 2009 at 3:00 p.m. (Calgary time). Shareholders not attending the meeting are encouraged to complete the form of proxy and deliver it in accordance with the instructions therein at their earliest convenience.

GLOSSARY

ARC	asset retirement costs
ARO	asset retirement obligations
/d	per day
boe	barrels of oil equivalent (6 mcf of natural gas = 1 barrel of oil equivalent)
bbls	barrels
GOR	gross overriding royalties
mboe	thousand barrels of oil equivalent
mbbl	thousand barrels
mcf	thousand cubic feet
mmcf	million cubic feet
NGL	natural gas liquids
NI 51-101	National Instrument 51-101
WTI	West Texas Intermediate, a benchmark crude oil used for pricing comparison

TABLE OF CONTENTS

Cover painting "A Steady Climb" by Paul Van Ginkel (www.paulvanginkel.com)

Financial and Operating Highlights

		2008		2007
FINANCIAL				
Petroleum and natural gas revenue (before royalties)	$	**20,634,939**	$	782,843
Funds flow from operations [1]	$	**12,757,791**	$	602,956
Per share - basic and diluted [2]	$	**0.38**	$	0.07
Cash flow from operating activities	$	**13,599,073**	$	166,548
Net earnings	$	**5,453,146**	$	157,448
Per share - basic and diluted [2]	$	**0.16**	$	0.02
Capital expenditures, including ARC, net	$	**72,714,077**	$	6,147,396
Net working capital	$	**11,834,615**	$	16,250,793
Total assets	$	**97,193,946**	$	26,194,023
Shares outstanding				
Class A		**28,222,700**		15,282,700
Class B		**1,173,600**		1,173,600
OPERATIONAL				
Daily sales volumes				
Oil sales *(bbls/d)*		**386**		25
Natural gas liquids *(bbls/d)*		**17**		-
Natural gas *(mcf/d)*		**2,149**		-
Total *(boe/d)*		**761**		25
Realized prices				
Oil *($/bbl)*	$	**94.50**	$	85.46
Gas *($/mcf)*	$	**8.59**		-
Field operating netbacks				
Oil - Southeast Saskatchewan operations *($/bbl)*	$	**65.89**	$	62.06
Gas and liquids - Northeast British Columbia operations *($/boe)*	$	**26.41**		-
Company combined *($/boe)*	$	**46.45**	$	62.06
Net developed and undeveloped land				
Southeast Saskatchewan *(acres)*		**54,010**		6,605
Northeast British Columbia *(acres)*		**93,867**		-
Total *(acres)*		**147,877**		6,605
Total proved and probable reserves *(mboe, 6:1)*		**4,360.2**		553.0
Wells drilled [3]				
Gross		**50**		6
Net		**21.33**		2.41
Net success rate		**86%**		100%

1. This table contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than "cash flow from operating activities" as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. Therefore reference to funds flow from operations or funds flow from operations per share (basic and diluted) may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and leverage and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment. The reconciliation between funds flow from operations and cash flow from operating activities can be found in "Management's Discussion and Analysis". Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period after the deemed conversion of the Class B shares to Class A shares.

2. Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Trading Price, defined as being the weighted average trading price of the Class A shares for the last 30 consecutive trading days.

3. "Gross and net wells drilled" in 2008 excludes a salt water disposal well, and includes a stratigraphic well. "Net wells drilled" refers to net revenue interest. "Net success rate" in 2008 excludes a stratigraphic well. Gross and net wells drilled in 2008 exclude 2 (1.0 net) gas wells drilled between acquisition effective and close date.

To Our Shareholders

Painted Pony's first full year of operations was remarkable, in a number of ways. The global economic environment was initially heated, then collapsed. Competition, cash flows, share prices and drilling activity were at record levels, and then evaporated. Almost overnight, the oil and gas sector discovered that access to credit and incremental capital became scarce, forcing organizations to operate within their existing means. The combination of high quality assets and conservative financial management has positioned the Company to not only weather the storm, but to continue a "Steady Climb" through these very turbulent times.

Despite this turmoil, Painted Pony's strategic business plan enabled the Company to achieve the following during 2008:

- *crossing the 1,000 boe/d benchmark in September, to average 1,173 boe/d in the fourth quarter;*
- *aggregating 147,877 net acres in Saskatchewan and British Columbia, with undeveloped land independently valued at $58.4 million;*
- *growing proved and probable reserves 688%,to 4,360 mboe; and*
- *exiting 2008 with positive working capital of $11.8 million and undrawn available credit facilities of $22 million.*

TARGETING THE BAKKEN IN SASKATCHEWAN

Painted Pony's initial focus was to extend the boundaries of the Bakken field surrounding the towns of Stoughton and Viewfield. Drawing on experience of the Company's geoscientists, who were involved in the discovery of the first commercial horizontal Bakken wells in the Stoughton/Viewfield area, Painted Pony began drilling exploration wells in the Midale and Kisbey areas, as part of two farm-in agreements. As the Bakken play became recognized as highly profitable, competitors poured money into land sales and corporate acquisitions. Having already established a strong land position, Painted Pony stayed true to its business plan, enjoying steady drilling success.

In 2008, the Company drilled 48 (20.3 net) wells in Saskatchewan, primarily Bakken wells in the Kisbey, Midale and Weyburn areas. By the end of 2008, Painted Pony had accumulated 54,000 net acres of developed and undeveloped land, of which 98% were undeveloped. Fourth quarter sales in Saskatchewan increased to 620 bbls/d of light oil.

Within the Bakken play, technology has continued to evolve. Resource plays justify experimenting with new approaches, then applying successes to subsequent operations. Painted Pony recently drilled two shortened horizontal wells at a 100% working interest. The wellbores are approximately half the length of conventional horizontal Bakken wells, but have the same number of fracture treatments, thereby "down-spacing" the fractures. The Company believes there are multiple advantages to this new technique. Most importantly, with the fracture treatments closer together, a higher percentage of the reservoir is stimulated; it is believed this will result in higher recovery factors. To date there has been no discernable difference in production performance using this new technique. Shorter wells also cost less to drill, reduce the need for pooling of mineral rights, and could effectively double the number of viable locations.

As commodity prices declined in the second half of 2008, Painted Pony revised its drilling program to minimize risk and optimize cash flow. The Company drilled its first "down-spaced" well, resulting in three full-length wells per half section of land, rather than two. The well is on production and is showing no signs of interference. The Company has also focused on drilling on unencumbered crown lands which enjoy reduced royalties. As oil prices stabilize, Painted Pony will resume exploratory drilling to further extend the Bakken field. Meanwhile, capital costs are improving as industry activity has decreased; since mid-year 2008, rig utilization and demand for services has dropped, which resulted in a material reduction in costs.

TARGETING CONVENTIONAL AND UNCONVENTIONAL GAS IN BRITISH COLUMBIA

In March of 2008, the Company acquired a multi-zone, gas producing asset in Northeast British Columbia. The acquisition included 89,600 net acres of developed and undeveloped land, and 450 boe/d of production. The Company subsequently participated in the successful drilling of two (1.0 net) vertical wells and recompletion of one (1.0 net) well, all targeting the Bluesky zone.

To Our Shareholders

At the end of 2008, Painted Pony had accumulated 93,900 net developed and undeveloped acres of land (79% undeveloped) in Northeast British Columbia. In the fourth quarter of 2008, sales averaged 553 boe/d, weighted 96% gas and 4% NGL's. With access to a seismic database of 1,400 square kilometers of three-dimensional seismic and 1,200 kilometers of two-dimensional seismic, Painted Pony proceeded to evaluate the lands for potential resource-style plays; two emerged.

UNCONVENTIONAL GAS - MONTNEY

The Triassic Montney formation is an areally-extensive, dolomitic siltstone and shale resource play that has been developed to the south and east of the Company's Blair/Cameron properties. Industry competitors are now drilling wells targeting the Montney on lands directly offsetting Company lands. The Company currently has over 60,000 net acres of land with Montney rights. In the Blair/Cameron area, the Montney zone is sweet, over-pressured and gas-charged. Painted Pony entered into two farm-out agreements with an active Montney exploration company in order to evaluate its Montney potential with minimal capital exposure. The partner has committed to drill at minimum four wells; the first two wells began drilling late in 2008 and early in 2009.

UNCONVENTIONAL GAS - BUCKINGHORSE/ FORT ST. JOHN GROUP SHALES

The Buckinghorse formation is an organic-rich, Cretaceous-aged shale up to 800 meters thick. The zone is over-pressured, gas-charged and shallow, found between 400 and 1200 meters in depth. The Company holds over 70,000 net acres of land on the trend, and while the commerciality of the resource has not been established, the resource potential is significant.

In the fourth quarter of 2008, Painted Pony participated in the experimental re-completion of two vertical wells in the Blair area. Both wells were completed throughout the Buckinghorse formation and have been placed on production at modest rates. Continued experimental drilling and completion techniques are planned for the remainder of 2009.

THE STEADY CLIMB CONTINUES

Since commencing operations less than two years ago, Painted Pony has focused on three resource-style plays. Driven by a financially conservative mandate, the Company will continue to balance a scaled-back development drilling program until commodity markets improve.

Painted Pony appreciates the support of the Board of Directors, management, employees and consultants, who as owners of over 18% of the shares, are fully engaged in the Company's success. To the Company's business partners, suppliers and government agencies; Painted Pony thanks you for your cooperation and assistance, and recognizes the critical role you play in our success. And to all the shareholders, we thank you for your support and belief, as the Company continues its "Steady Climb".

On Behalf of the Board of Directors

Patrick R. Ward
President & Chief Executive Officer
April 1, 2009

"Adversity causes some men to break; others to break records" ~ William A. Ward

Review of Operations

Focus Areas

Painted Pony commenced operations in May of 2007 following its initial public offering. The Company's business plan was two-fold. In Southeast Saskatchewan, where the Company had two large farm-in agreements, the objective was to explore for high-quality, light sweet oil. In Northeast British Columbia, the Company had access to a large seismic data base that it planned on using to generate high impact, multi-zone resource-type plays.

Drilling commenced in June of 2007. By year-end 2007, the Company had drilled a total of five (1.91 net) horizontal Bakken oil wells and one (0.5 net) vertical oil well targeting the Midale formation. Sales in 2007, which came on late in the year, averaged 25 bbls/d of light crude oil. By the end of 2007, the Company had accumulated 295 net developed and 6,310 net undeveloped acres within Saskatchewan. Operations in British Columbia in 2007 comprised the evaluation of potential plays using the seismic data base.

In 2008, the Company expanded its operations through drilling and asset acquisitions combined with drilling to earn land, freehold leasing and purchases at crown land sales. Significant milestones were achieved in both core areas. During 2008, Painted Pony:

- *drilled 50 (21.3 net) wells at a net success rate of 86%*
- *established a land base of 54,000 net acres of developed and undeveloped land (98% undeveloped) in Southeast Saskatchewan and 93,900 net developed and undeveloped acres of land (79% undeveloped) in Northeast British Columbia; and*
- *grew sales volumes to an average 761 boe/d (weighted 53% oil and liquids); with fourth quarter sales averaging 1,173 boe/d (weighted 55% oil and liquids).*

Painted Pony continues to monitor its capital spending program in light of the turmoil in the equity and commodity markets. The Company has adjusted its 2009 capital program as necessary to continue to conservatively manage its balance sheet. Painted Pony drilled two horizontal Bakken oil wells 100% and one (0.5 net) Bluesky/Gething gas well during the first quarter of 2009. The Company is currently evaluating its 2009 second to fourth quarter budget plans.

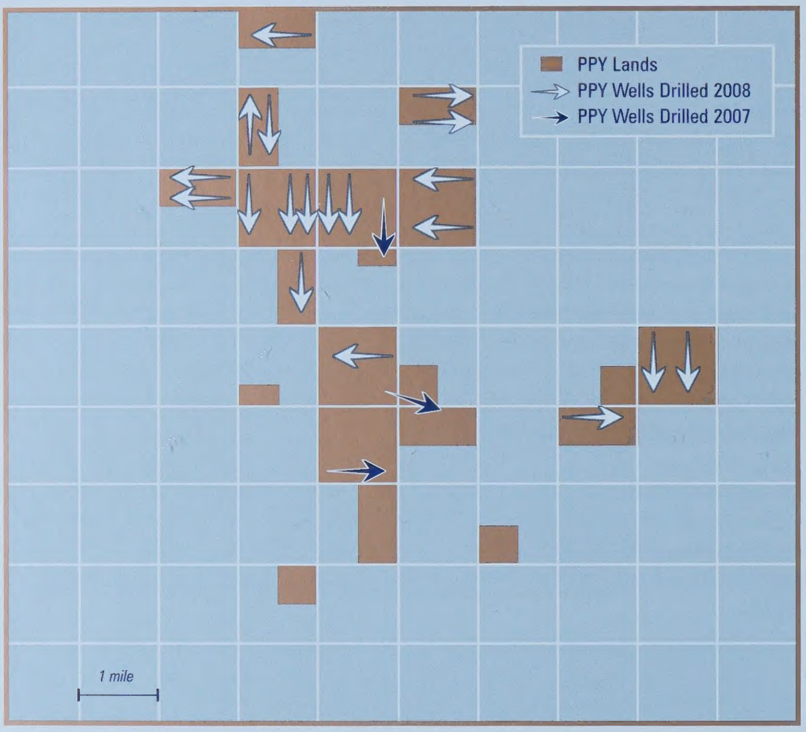
SOUTHEAST SASKATCHEWAN

Painted Pony's operations in Saskatchewan are primarily located north of Estevan in the general areas east and west of the town of Stoughton. Two large farm-in agreements in 2007 in the Midale and Kisbey areas gave the Company the initial access to these lands. By the end of 2008, Painted Pony had accumulated 54,000 net acres of developed and undeveloped land, of which 98% were undeveloped.

This area in Saskatchewan is prospective for high netback, light sweet oil from the Bakken, Midale, Frobisher and Alida formations. The Bakken play, one of the largest conventional light oil discoveries in Western Canada, is a widespread marine dolomitic sandstone deposit that covers over one hundred townships (3,600 square miles) of land within Southeast Saskatchewan. The formation has long been believed to contain very significant light oil reserves. However, this vast resource was not exploited aggressively until certain technological advances, including horizontal drilling and multistage fracture stimulation techniques were successfully applied in the region. Provincial royalty incentive programs also significantly enhanced the economics of exploiting the Bakken in this region.

Painted Pony's main target in Southeast Saskatchewan is light, sweet oil from the Bakken formation. In 2007, the Company drilled six (2.4 net) wells focused in the Kisbey and Midale areas. During 2008, the Company drilled a total of 48 (20.3 net) wells primarily in the Kisbey, Midale and Weyburn areas. Sales of light oil from 18.4 net wells in 2008 averaged 386 bbls/d and averaged 620 bbls/d in the fourth quarter of 2008. Field netbacks (being per unit sales less royalties, transportation and operating costs) in 2008 averaged $65.89/bbl.

Southeast Saskatchewan



Kisbey

KISBEY

The Kisbey area, located approximately 30 miles northeast of the town of Estevan and east of Stoughton, produces 43 degree API light oil from the Bakken formation. Painted Pony acquired its interests in the area through a January 7, 2007 farm-in agreement.

In June 2007 the Company commenced drilling its first light sweet oil horizontal well, paying 37.5% of the cost of drilling the test well to earn a 26.25% working interest in an earning block comprised of two gross sections of the farmor's lands. By December 31, 2007 Painted Pony had drilled three (0.9 net) wells under the farmout agreement and had 479 gross (150 net) acres of developed land and 3,422 gross (937 net) acres of undeveloped land in the Kisbey area.

In 2008, the Company drilled 19 gross (4.23 net) wells in the Kisbey area. Painted Pony's land position grew to 6,763 gross (1,755 net) acres in the area, of which 87% of the net land is undeveloped. Sales of light oil in 2008 from the Kisbey area averaged 146 bbls/d and 224 bbls/d during the fourth quarter of the year.

During the first quarter of 2009, a number of wells within the Kisbey were tied in to a partner gas plant, enabling the sale of solution gas and associated gas condensate. The Company currently anticipates minimal drilling expenditures in the area during 2009 due to budgetary constraints.

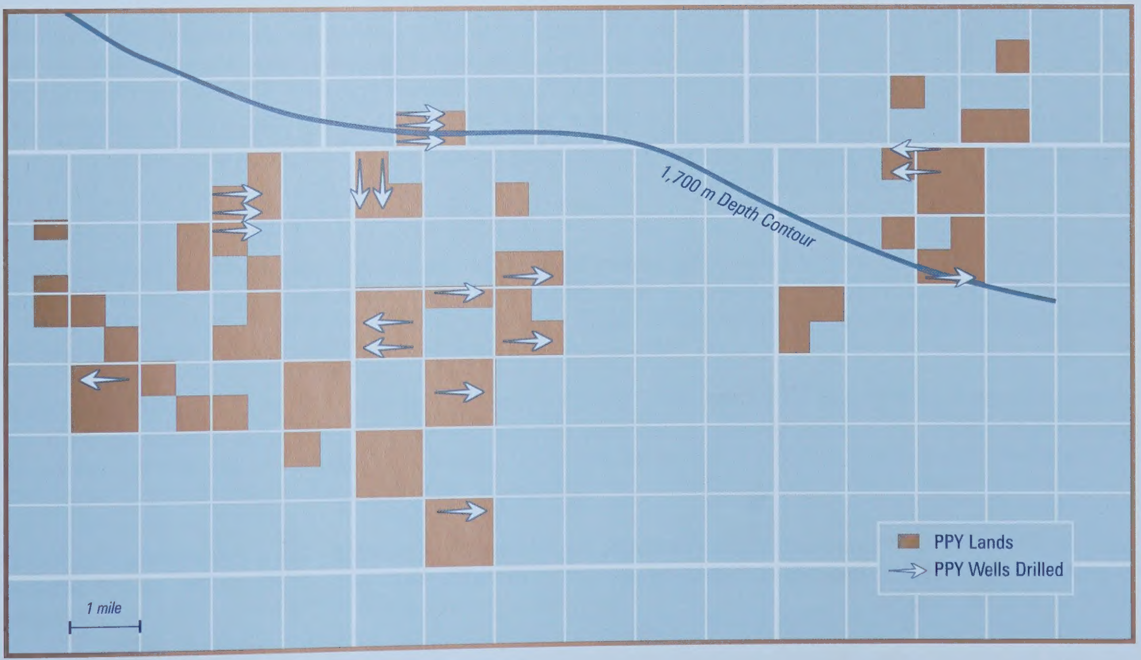
MIDALE

The Midale area, located southwest of the town of Stoughton, produces 43 degree API light oil from the Bakken formation. Painted Pony acquired its initial interests in the Midale area through a March 2007 farm-in agreement where the Company earned 100% of the farmor's working interest subject to a non-convertible gross overriding royalty and two gross sections earning. In 2007, Painted Pony drilled two (1.0 net) wells and had 211 gross (105 net) acres of developed land and 2,228 gross (1,024 net) acres of undeveloped land in the Midale area.

In January of 2008, Painted Pony executed another farm-in agreement allowing access to an additional land block. Under the terms of the agreement, Painted Pony paid 60% to earn a 40% working interest in the lands and committed to drill four wells. During 2008, all commitments under the terms of the farm-in agreement were satisfied.

In March of 2008, an additional farm-in agreement allowed the Company access to additional prospective lands. This agreement committed the Company to drilling two gross (1.3 net) wells, which was fully satisfied during the year.

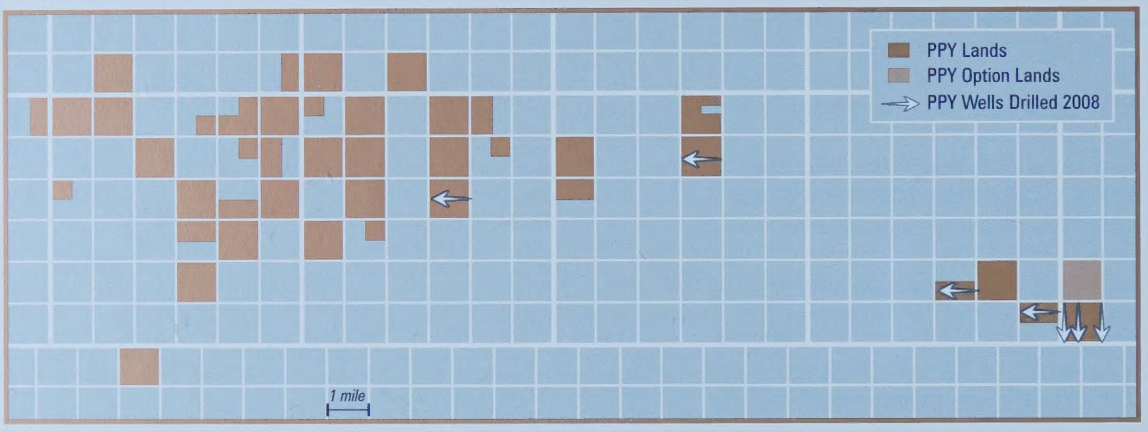
By the end of 2008, Painted Pony had accumulated 4,420 net acres of land, of which 92% was undeveloped. During the year, 17 (7.45 net) wells were drilled in the Midale area. Sales of light oil in 2008 from the Midale area averaged 171 bbls/d and 236 bbls/d during the fourth quarter of the year.



Midale

Review of Operations

Weyburn



WEYBURN

During 2008, Painted Pony's team spearheaded the extension west of the Bakken-pool into the Weyburn area, located west of the Company's Midale area. The Company aggregated 19,311 net acres of land through land sales, farm-in wells and freehold leasing. To date, Painted Pony has drilled 8 (5.4 net) wells in this area. Sales of light oil in 2008 from the Weyburn area averaged 61 bbls/d and 150 bbls/d during the fourth quarter when the Company shut-in selected higher operating and transportation cost wells pending improved commodity prices.

OTHER

Painted Pony has 28,524 net acres of lands in other areas of Southeast Saskatchewan, prospective for the Bakken and other zones. The Company has delayed the exploration of these lands pending an expanded capital budget. In the Alameda and Bienfait areas three (2.25 net) wells were drilled in 2008 targeting the Frobisher zones.

Northeast British Columbia

NORTHEAST BRITISH COLUMBIA

On March 31, 2008, Painted Pony closed the acquisition of gas producing assets located in Northeast British Columbia, effective February 1, 2008. At the end of 2008, Painted Pony had accumulated 93,900 net developed and undeveloped acres of land (79% undeveloped) in Northeast British Columbia.

Currently, the Company has access to a seismic database accessing 1,400 square kilometers of three-dimensional seismic and 1,200 kilometers of two-dimensional seismic. Approximately 500 square kilometers of this seismic is over lands purchased. The Company believes seismic interpretation has been demonstrated to be a reliable tool in the identification of drill prospects, resulting in new drilling locations being mapped.

This area has good road infrastructure, under-utilized pipelines and gas plants and is generally accessible nine months per year, excluding breakup. Play economics have been enhanced by recent improvements to the British Columbia royalty incentive programs.

Painted Pony has been evaluating three potential play types within the Northeast British Columbia assets; gas from the Bluesky, Gething and Halfway zones, and unconventional gas from the Montney zone and gas in the Buckinghorse shale formations. Both of the unconventional targets have the potential to be high-impact resource plays.

Review of Operations

CONVENTIONAL GAS

Painted Pony's sales in Northeast British Columbia are primarily from the Bluesky/Gething zones in the Blair, Cypress and Cameron areas. Gas and NGL sales averaged 375 boe/d in 2008 from 12.3 net wells subsequent to the first quarter of 2008. In the fourth quarter of 2008, sales averaged 553 boe/d, weighted 96% gas and 4% NGLs.

In the interim period between the effective date and the closing date, two (0.55 net) successful Bluesky wells were drilled. The Company subsequently participated in the successful drilling of two (1.0 net) vertical wells and recompletion of one (1.0 net) well all in the Bluesky zone. In 2009, activity levels will depend on commodity prices and partner activity levels. Currently, the Company expects to drill three to four wells targeting the Bluesky zone each with a 50% working interest during 2009.

MONTNEY

The Company's Northeast British Columbia lands are situated on the Montney play fairway. The Company also believes that this resource play is being actively pursued by other companies on lands offsetting the Company's land blocks.

The Company has entered into two farm-out agreements in Northeast British Columbia allowing an oil and gas competitor to farm-in on portions of the Montney rights in the Cypress and Cameron areas. Under the terms of the agreements, four Montney/Doig tests will be drilled on those land blocks. The first well on the Cypress block commenced drilling at the end of 2008 and the second well on the Cameron block commenced drilling mid-way during the first quarter of 2009. The farmee has committed to drilling two additional Montney wells on the Cameron block in 2009. Both agreements contain rolling option provisions whereby additional lands can be earned through conducting additional activities on the farm-out lands.

Painted Pony is currently evaluating the drilling of additional Montney tests on offsetting higher working interest lands, particularly in the Blair/Julienne block.

BUCKINGHORSE/FORT ST. JOHN GROUP SHALE

The Company participated in the experimental recompletion and tie-in of two Buckinghorse/Fort St. John Group shale wells as part of a pilot program. This shale interval is gas-charged, over-pressured, organically-rich and up to 800 meters thick starting at about 400 meters from surface. Both wells flowed gas and have been placed on production for further evaluation. The Company is encouraged by the initial results on this new resource-type project but notes that it is in the very early stages of proving up the commercial viability of the project. The Company is considering additional drilling/completions targeting the Buckinghorse/Fort St. John shale gas play during 2009.

LAND HOLDINGS

Painted Pony's fundamental philosophy is growth through the identification of potentially prospective new areas. Whether the growth comes through the drill bit or accretive acquisitions, a significant land base is critical to carrying out this business plan, as the early identification of prospective lands allows the Company to acquire a meaningful acreage position before costs escalate as competition from other larger industry competitors intensifies.

As at December 31, 2008, Painted Pony's land position was as follows:

***Summary of Land** (acres)* [1]

	Undeveloped		Developed		Total	
	Gross	Net	Gross	Net	Gross	Net
Saskatchewan						
Kisbey	5,829	1,533	933	223	6,763	1,755
Midale	10,045	4,062	817	357	10,862	4,420
Weyburn	19,979	19,114	281	197	20,260	19,311
Other	29,447	28,280	300	245	29,746	28,524
	65,300	52,989	2,331	1,022	67,631	54,010
British Columbia						
Cypress	37,379	13,058	7,250	3,165	44,629	16,223
Cameron	52,369	26,460	3,016	1,481	55,385	27,941
Blair	34,454	17,024	27,048	13,314	61,503	30,337
Other	22,717	17,548	5,089	1,817	27,805	19,366
	146,919	74,090	42,403	19,777	189,322	93,867
Total	212,219	127,078	44,734	20,799	256,953	147,877

1. Numbers in this table are subject to rounding error.

As at December 31, 2008, in a report prepared by Seaton-Jordan and Associates Ltd. ("Seaton-Jordan"), the Company's undeveloped land in Saskatchewan and British Columbia was valued at $58.4 million. Seaton-Jordan's assessment of the Company's lands was prepared in accordance with National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities ("NI 51-101").

Reserves

Painted Pony's reserves were evaluated by Sproule Associates Limited ("Sproule") effective as of December 31, 2008 in a report dated March 10, 2009 (the "Sproule Report"). The Reserves Sub Committee is comprised of independent board members appointed by the Board of Directors of Painted Pony. The Committee has reviewed the report in accordance with its mandate.

The Sproule report was prepared in accordance with NI 51-101. This instrument adopted by the Canadian Securities Administrators, sets out standards of disclosure for oil and gas activities and mandates the application of evaluation standards defined in the Canadian Oil and Gas Evaluation Handbook (COGEH). The information that follows has been derived from the Sproule Report.

The estimates of reserves are subject to revisions as additional reservoir and performance information become available, and contain judgments of future events for which the actual results may vary materially. The reader is referred to the Company's Statement of Reserves Data and Other Oil and Gas Information Form, which it is anticipated will be filed before the end of April 2009 on the Company's website and on www.sedar.com. This Annual Report contains extracts of Painted Pony's reserves only.

At December 31, 2008 the Company's proved and probable working interest reserves, using forecast prices and costs, were 4,360.2 Mboe (weighted 52% oil and natural gas liquids) compared to 553.0 Mboe of light and medium oil at December 31, 2007. At December 31, 2008, Painted Pony's total proved working interest reserves were 2,747.5 Mboe, an increase of 1,262% compared to 201.7 Mboe at December 31, 2007.

Summary of Oil and Gas Working Interest Reserves[1][3]
Forecast Prices and Costs

	As at Dec 31, 2008				As at Dec 31, 2007
	Natural gas[4] *(mmcf)*	**Light and medium oil** *(mbbl)*	**Natural gas liquids** *(mbbl)*	**Total** *(mboe[2], 6:1)*	**Total** *(mboe[2], 6:1)*
Proved					
Developed producing	**6,258**	**689.8**	**65.4**	**1,798.1**	77.7
Developed non-producing	**1,531**	**30.6**	**49.9**	**335.6**	-
Undeveloped	**560**	**482.4**	**38.1**	**613.8**	124.0
Total proved	**8,349**	**1,202.7**	**153.3**	**2,747.5**	201.7
Probable	**4,152**	**793.8**	**126.8**	**1,612.7**	351.3
Total proved plus probable	**12,501**	**1,996.6**	**280.2**	**4,360.2**	553.0

1. *Painted Pony's total working interest reserves before royalties owned by others.*
2. *Natural gas is converted to barrels of oil equivalent ("boe") at a ratio of six thousand standard cubic feet to one barrel of oil.*
3. *Numbers in this table are subject to rounding error.*
4. *Includes non- associated gas, associated gas and solution gas.*

"Gross" reserves (being working interest reserves, excluding royalty interest reserves, before deduction of royalty burdens payable) is disclosed. The reserve report was prepared utilizing definitions as set out under National Instrument 51-101.

NET PRESENT VALUE OF FUTURE NET REVENUE

The forecast prices used in the reserve report effective December 31, 2008 were Sproule's published Forecast Prices and Costs as at December 31, 2008. The estimated future net revenues are stated before deducting future estimated site restoration costs and reduced for estimated future well abandonment costs, the Saskatchewan Capital Tax and estimated capital for future development associated with the reserves.

In the reserve report, the net total future capital required to bring undeveloped proved and probable reserves onto production is estimated to be $22,195,000, an incremental $12,220,000 from 2007, over the life of the reserves.

Summary of Net Present Values of Future Net Revenue [1] [2] [3]
Forecast Prices and Costs *($000s)*
Before Income Taxes [2]***, Discounted at*** *(%/year)*

	As at Dec 31, 2008					As at Dec 31, 2007	
	0%	5%	10%	15%	20%	0%	10%
Proved							
Developed producing	59,234	46,406	38,389	32,960	29,055	3,802.6	3,309.5
Developed non-producing	9,081	6,624	5,176	4,238	3,587	-	-
Undeveloped	19,967	12,772	8,577	5,864	3,975	2,966.0	1,916.9
Total proved	88,282	65,802	52,142	43,062	36,617	6,768.6	5,226.4
Probable	66,041	38,759	25,912	18,702	14,143	10,978.6	6,921.0
Total proved plus probable	154,324	104,561	78,054	61,763	50,760	17,747.2	12,147.4

1. Numbers in this table are subject to rounding error.
2. Values are net of abandonment liabilities.
3. The net present values of future net revenue do not represent fair market value.

Summary of Pricing and Inflation Rate Assumptions
Forecast Prices and Costs
As at December 31, 2008

	WTI Cushing Oklahoma	Edmonton Par price 40 API	Inflation rates	Henry Hub price	AECO-C Spot	Exchange rate
	($US/bbl)	($Cdn/bbl)	(%/year)	($US/mmbtu)	($Cdn/mmbtu)	($US/$Cdn)
2009	53.73	65.35	2.0	6.30	6.82	0.800
2010	63.41	72.78	2.0	7.32	7.56	0.850
2011	69.53	79.95	2.0	7.56	7.84	0.850
2012	79.59	86.57	2.0	8.49	8.38	0.900
2013	92.01	94.97	2.0	9.74	9.20	0.950
2014	93.85	96.89	2.0	9.94	9.41	0.950
2015	95.72	98.85	2.0	10.14	9.62	0.950
2016	97.64	100.84	2.0	10.34	9.83	0.950
2017	99.59	102.88	2.0	10.54	10.05	0.950
2018	101.58	104.96	2.0	10.76	10.27	0.950
2019	103.61	107.08	2.0	10.97	10.50	0.950
Thereafter	+2%/yr	+2%/yr	2.0	+2%/yr	+2%/yr	0.950

RESERVE LIFE INDEX

The reserve life index is calculated by dividing reserves as at the effective date of the report (December 31, 2008) by the production during the applicable period, and represents a measure of the amount of time production could be sustained at the production rates based on the reserves at the applicable point in time. Based upon the year-end reserve volumes and the average fourth quarter 2008 production rate for Painted Pony, sufficient reserves exist to continue production at the current rate for approximately ten years based on proved and probable reserves, and over six years based on proved reserves.

Reserve Life

Years	Proved	Proved and probable
Natural gas	7.1	10.7
Crude oil and NGLs	5.7	9.6
Total boe	6.4	10.1

PRODUCTION REPLACEMENT RATIO

The production replacement ratio measures the number of times the fourth quarter's production annualized has been replaced by net reserve additions. Painted Pony's production replacement ratio reflects the addition of reserves at a cost effective rate.

	2008	2007
Proved basis	**6.5 x**	6.1 x
Proved and probable basis	**9.5 x**	16.3 x

The following Management's Discussion and Analysis ("MD&A") of consolidated financial results as provided by the management of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2008. This commentary is dated April 1, 2009. The financial data presented is in accordance with Canadian generally accepted accounting principles ("GAAP") in Canadian dollars, except where indicated otherwise. These documents and additional information about Painted Pony are available on SEDAR at www.sedar.com.

DESCRIPTION OF COMPANY

Painted Pony is a Calgary based exploration and development company focused on conventional oil, primarily targeting the Bakken formation, in Southeast Saskatchewan and natural gas in Northeast British Columbia. Shares of Painted Pony trade on the TSX Venture Exchange under the symbols PPY.A and PPY.B.

NON-GAAP MEASURES

Management's Discussion and Analysis contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with GAAP as an indicator of the Company's performance. Therefore, reference to funds flow from operations or funds flow from operations per share (basic and diluted) may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment and to repay debt. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after deemed conversion of Class B shares into Class A, consistent with the calculations of earnings per share. The Company reconciles funds flow from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP, as follows:

	Year ended December 31, 2008	Period ended December 31, 2007
Cash flow from operating activities	$ 13,599,073	$ 166,548
Changes in non-cash working capital	(971,797)	436,408
Asset retirement expenditures	130,515	-
Funds flow from operations	$ 12,757,791	$ 602,956

Management's Discussion and Analysis also contains other industry benchmarks and terms, such as net working capital position and operating netbacks, which are not recognized measures under GAAP. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and liabilities the Company has and, secondly, the profitability relative to commodity prices. Readers are cautioned, however, that these measures should not be construed as alternatives to other terms such as current and long-term debt or net income determined in accordance with GAAP as measures of performance. Painted Pony's method of calculating these measures may differ from other companies, and accordingly, may not be comparable to measures used by other companies.

BOE PRESENTATION

Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet ("mcf") to one barrel ("bbl") is used as an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in this report are derived by converting natural gas to oil in the ratio of six mcf of gas to one barrel of oil. Readers should be aware that historical results are not necessarily indicative of future performance.

FORWARD-LOOKING INFORMATION

This MD&A contains forward-looking statements relating to future events. Forward-looking information is information that does not relate strictly to historical or current facts, and can be identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "believe", "intend", or similar expressions. These statements represent management's best projections, expectations, and estimates as of the date of this document, but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the business risks discussed in the MD&A, which may cause actual performance and financial results to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements.

The forward looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect; including but not limited to the following:

a) The expectation that the discounted price the Company received in November and December of 2008 in comparison to reference prices is a temporary aberration, and the expectation that the price of Company crude will generally approximate the Edmonton light reference price.

b) The expectation that the Company and its partners will pursue cost-savings opportunities in the Midale area in 2009 similar to the installation of a gathering system and subsequent oil transportation cost savings in the Kisbey area mid-year 2008.

c) The expectation that additional volumes in the second quarter of 2009 from a well recompletion will contribute towards the excess capacity costs for the BC firm service contract.

d) The expectation that production levels in 2009 are expected to show modest growth from fourth quarter production rates.

e) The expectation that the tax pools for which a tax asset has been recorded will be utilized.

f) The expectation that commodity prices will be volatile throughout 2009 and, overall, lower than 2008 prices; this is subject to the impact of actual energy market conditions, including supply available relative to demand.

g) The expectation that income in 2009 from the rental of tubular pipe will diminish in comparison to 2008 as operated capital expenditure levels decrease.

h) The expectation that the risk of accounts receivables becoming uncollectible is mitigated by the financial position of the entities.

i) The anticipation that the Company has sufficient financial resources with which to conduct the capital program; this is subject to the risk and uncertainty that the drilling rigs, field service providers, completion and tie in equipment will be available as required and that the costs of securing such services and equipment will not materially exceed expectations.

While we anticipate that subsequent events and developments may cause our views to change, we do not have an intention to update this forward-looking information, except as required by applicable securities laws. This forward-looking information represents our views as of the date of this document and such information should not be relied upon as representing our views as of any date subsequent to the date of this document. We have attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. Other risks and uncertainties include, but are not limited to, the following:

- *Normal risks common to the oil and natural gas industry, including various operational risks in the carrying out of exploration, development and production operations,*
- *Risks and uncertainty of oil and gas geological deposits,*
- *Revisions, amendments or changes to capital expenditure plans including exploration, development and exploitation projects,*
- *Risks as to the availability and pricing of appropriate financing alternatives,*
- *Potential changes in income tax regulations, governmental policies, rules, practices or approval process changes, or delays, or enhancements, and*
- *Ability to attract and retain qualified professional employees.*

There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. From time to time, Painted Pony's management makes estimates and forms opinions on which the forward-looking statements are based. The Company assumes no obligation to update forward-looking statements if circumstances, management's estimates, or opinions change unless prescribed by securities laws.

OVERVIEW

In February 2007, the Company entered into a series of agreements whereby it reorganized itself. The Company was continued into Alberta under the Business Corporation Act (Alberta) and articles of amendment were filed effecting name changes. All of the assets and liabilities were sold or assigned, and a private placement consisting of 240,000 Common Voting Shares and a convertible debenture in the principal amount of $347,500 was completed. The convertible debenture was secured, bore interest at the rate of 5% per annum during the first two years of its term and at bank prime rate plus 3% thereafter and was convertible into Common Non-Voting Shares of the Company at a price of $0.15625 per Common Non-Voting Share. The Company created an unlimited number of non-voting common shares and consolidated the issued common shares on the basis that up to 2,500 of such shares became one common share. The Company then had 196 issued and outstanding common voting shares.

On March 27, 2007, the Company entered into a financing agreement ("Financing Agreement") pursuant to which the Company reconstituted the Company's Board of Directors, reorganized the share capital of the Company and filed articles of amendment to change the name to Painted Pony Petroleum Ltd., all of which were approved by the shareholders of the Company on March 29, 2007 and which were effected on April 3, 2007.

The 196 issued and outstanding common voting shares were exchanged for:

(i) 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting share, and
(ii) 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.

Completion of the reorganization of the Company, as contemplated in the Financing Agreement was conditional upon the closing of the initial public offering, which occurred on May 17, 2007.

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. Pursuant to "Comprehensive Revaluation of Assets and Liabilities" of the Canadian Institute of Chartered Accountants ("CICA") Handbook, the Company is entitled to use "fresh start" accounting which means that prior or comparative financial information is not required to be presented, as it would not be meaningful to the reader. Accordingly, financial information is presented commencing on April 3, 2007.

On May 23, 2007, subsequent to completion of an initial public offering on May 17, 2007, the Class A shares and Class B shares of Painted Pony Petroleum Ltd. began trading on the TSX Venture Exchange under the symbols "PPY.A" and "PPY.B" respectively. Painted Pony then commenced an active operated exploration program, focused on SE Saskatchewan and NE British Columbia.

NET EARNINGS AND FUNDS FLOW FROM OPERATIONS

Painted Pony generated funds flow from operations of $12,757,791 for the year ended December 31, 2008, compared to $602,956 for the period ended December 31, 2007. Basic and diluted funds flow from operations per share is $0.38 for year ended December 31, 2008, compared to $0.07 per basic and diluted share for the period ended December 31, 2007.

Cash flow from operating activities was $13,599,073 for the year ended December 31, 2008, compared to $166,548 for the period ended December 31, 2007.

Painted Pony produced earnings of $5,453,146 for the year ended December 31, 2008 and $157,448 for the period ended December 31, 2007. Basic and diluted earnings per share are $0.16 for the year ended December 31, 2008, compared to $0.02 per basic and diluted share for the period ended December 31, 2007.

SALES VOLUMES

During the year and period respectively ended December 31, 2008 and 2007, Painted Pony's average sales volumes averaged 761 boe/d and 25 boe/d respectively. Daily sales volumes increased 2,944% in 2008 compared to the prior period, the result of incremental crude oil from the Southeast Saskatchewan drilling program combined with sales from gas producing properties in Northeast British Columbia subsequent to the first quarter acquisition of the Northeast British Columbia properties followed by a successful drilling program. For the 2008 year, all of Painted Pony's light oil sales originated from its Saskatchewan operations while sales of gas, condensate, NGL's and sulphur were from its Northeast British Columbia assets.

Average Daily Sales Volumes

	Year ended December 31, 2008	Period ended December 31, 2007
Light oil *(bbls/d)*	**386**	25
Condensate *(bbls/d)*	**12**	-
NGL's *(bbls/d)*	**5**	-
Gas *(mcf/d)*	**2,149**	-
Total *(boe/d)*	**761**	25

Crude oil sales for 2008 were from 45 gross (18.4 net) wells in the Midale, Kisbey, Weyburn and Alameda areas of Southeast Saskatchewan, compared to 4 gross (1.6 net wells) that commenced production in the latter half of 2007.

Gas, condensate and liquids sales in 2008 were from 26 gross (12.3 net) wells in the Blair, Cypress and Cameron areas of Northeast British Columbia. As the BC assets were purchased at the end of March 2008, there were no sales of gas, condensate and liquids prior to the second quarter of 2008.

REVENUES

Crude oil revenues in 2008 were $13,355,646 compared to $782,843 in 2007. The Company received an average oil price of $94.50/bbl in 2008 and $85.46/bbl for the period ending December 2007. During the second half of 2008, the dramatic reduction in the world oil price caused the Company to receive a discounted price in comparison to reference prices for November and December sales. Painted Pony believes this to be a temporary aberration, and expects the price of Company crude to generally approximate the Edmonton light reference price. Painted Pony's light oil is a premium light crude with low sulphur content. *

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Revenue from gas, condensate and NGL sales totaled $7,279,293 in 2008, all of which was generated subsequent to the first quarter of 2008. The Company received an average gas price of $8.59/mcf in 2008, a premium of approximately 5% to the AECO daily spot average gas reference price, reflecting the high heat content of the gas.

To date, Painted Pony has not undertaken any hedging or commodity price contracts.

Sales by Product

	Year ended December 31, 2008	Period ended December 31, 2007
Gas	**$ 6,756,984**	$ -
Condensate	**424,772**	-
NGL and sulphur	**97,537**	-
Light oil	**13,355,646**	782,843
Total	**$ 20,634,939**	$ 782,843

Average Benchmark Prices

		Year ended December 31, 2008	Period ended December 31, 2007
Exchange rate *(US$/Cdn$)*		**0.943**	0.935
Oil	- WTI *(US$/bbl)*	**99.59**	72.27
	- Edmonton par - light oil *($/bbl)*	**102.85**	77.06
Condensate	- Edmonton *($/bbl)*	**104.70**	-
NGL	- Edmonton, incl. ethane *($/bbl)*	**52.16**	-
Gas	- AECO, daily spot *($/mcf)*	**8.15**	-

Painted Pony's Realized Prices

	Year ended December 31, 2008	Period ended December 31, 2007
Oil *($/bbl)*	**94.50**	85.46
Condensate *($/bbl)*	**101.37**	-
NGL *($/bbl)*	**44.06**	-
Gas *($/mcf)*	**8.59**	-

ROYALTIES

In 2008, total royalties were $3,298,182 or approximately 16.0% of total revenue. Royalties for oil averaged 16.9%. Royalties for gas and associated products averaged 14.2%, after receiving a summer drilling royalty credit of $100,000. For the period ended December 31, 2007, total royalties were $112,285, or 14.3% of revenue, with no such summer drilling royalty credit in 2007.

Painted Pony's properties in Northeast British Columbia are on crown lands, while in Southeast Saskatchewan sales from its properties are primarily on freehold lands with some crown lands. Crown royalties in 2008 were 93% from the sale of gas. The Saskatchewan crown royalty incentive programs have resulted in minimal oil crown royalties. Freehold royalties were all from the sale of oil. Gross overriding royalties were 95% from the sale of oil on lands the Company has earned through farm-ins in Saskatchewan.

Royalties by Type

	Year ended December 31, 2008	Period ended December 31, 2007
Crown	**$ 1,076,864**	$ 7,751
Freehold	**1,549,660**	59,730
GOR	**671,658**	44,804
	$ 3,298,182	$ 112,285

Royalties as a % of Revenue

	Year ended December 31, 2008	Period ended December 31, 2007
Crown	**5.2**	1.0
Freehold	**7.5**	7.6
GOR	**3.3**	5.7
	16.0	14.3

TRANSPORTATION COSTS

Transportation costs for 2008 and 2007 were $1,873,052 and $43,400 respectively.

Transportation by Commodity

	Year ended December 31, 2008	Period ended December 31, 2007
Light oil	**$ 486,192**	$ 43,400
Gas and associated liquids	**1,386,860**	-
Net	**$ 1,873,052**	$ 43,400

In Saskatchewan, for the periods ended December 31, 2008 and 2007 transportation costs were 3.6% and 5.5%, respectively of gross oil revenues. These charges reflect trucking costs of hauling oil, to various sales points to address occasional capacity issues.

Oil transportation charges decreased in the Kisbey area mid-year 2008 subsequent to installation of a gathering system and the expansion of the main area sales pipeline. The Company and its partners are evaluating the implementation of similar cost-saving opportunities in the Midale area in 2009. It is expected the opportunities will be pursued when economical to do so. *

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Gas gathering, processing and transmission services are provided by mid-stream processing companies. This allows companies to avoid allocating capital resources for facilities, on a firm-service or interruptible basis. The all-in charges for these services are included in transportation costs. In conjunction with the Northeast British Columbia assets, the Company is committed to a five mmcf/d firm-service contract to the end of October 2010. The cost for transporting the British Columbia gas and field products averaged $10.11/boe, including costs for excess capacity under the firm service contract. This will ensure incremental future volumes can be transported and processed. The Company anticipates additional volumes in the second quarter of 2009 from a well recompletion will contribute towards this excess capacity. *

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

OPERATING COSTS

Operating costs for the year ended December 31, 2008 were $2,529,304 or $9.08/boe compared to $58,609 for the period ending December 31, 2007, when operating costs were $6.40/boe.

Operating Costs

	Year ended December 31, 2008	Period ended December 31, 2007
Oil	**$ 1,293,701**	$ 58,609
Gas and associated liquids	**1,235,603**	-
Production expenses	**$ 2,529,304**	$ 58,609
Oil *($ per bbl)*	**$ 9.15**	$ 6.40
Gas and associated liquids *($ per boe)*	**9.01**	-
Operating cost *($ per boe)*	**$ 9.08**	$ 6.40

Operating costs for oil producing properties primarily consist of salt water disposal and hauling fees, equipment rentals for gas engines to run the pump jacks prior to electrification of each battery site, fuel and power expenditures, and contract operator fees. Overall, oil operating costs in 2008 increased as new Bakken oil areas, such as Weyburn and Midale commenced production. Mid-year 2008, a salt water disposal well and a multi-well battery and treatment facility in the Kisbey area combined with a gathering system helped to reduce operating costs in this area. Although Kisbey operating costs have declined, these cost savings have been offset by higher costs experienced at single well batteries in the new production areas.

Operating costs for gas and associated liquids properties primarily consist of contract operating fees, equipment rentals, compression fees, property taxes, and routine repairs and maintenance expenditures. Operating costs for gas and associated liquids have contributed to higher operating costs, with the addition of costs for gas compression, higher contract operating fees, and repair and maintenance expenditures on more mature properties.

OPERATING NETBACKS

For the periods ended December 31, 2008 and 2007, field operating netbacks averaged $46.45/boe and $62.06/boe respectively.

Combined Field Operating Netback *(per boe)*

	Year ended December 31, 2008	Period ended December 31, 2007
Revenues	**$ 74.10**	$ 85.46
Transportation costs	**(6.73)**	(4.74)
Royalties	**(11.84)**	(12.26)
Operating costs	**(9.08)**	(6.40)
Field operating netback	**$ 46.45**	$ 62.06

Netbacks by Commodity

	Year ended December 31, 2008	Period ended December 31, 2007
Crude oil *($/bbl)*	$ **65.89**	$ 62.06
Gas and associated products *($/boe)*	$ **26.41**	$ -

Netbacks for crude oil sales from the Southeast Saskatchewan operations were $65.89/bbl and $62.06/bbl respectively, for the periods ending December 31, 2008 and 2007. In comparison to 2007, the increased netback for crude oil in 2008 is primarily due to the significantly higher oil price during the first three quarters of the year, somewhat offset by higher operating costs.

Gas and products netbacks from the Northeast British Columbia operations averaged $26.41/boe for the year ending December 31, 2008. The Company had no gas or associated product sales in 2007.

GENERAL AND ADMINISTRATIVE

Net general and administrative expenses in 2008 were $1,047,148 compared to $364,012 in 2007. Total general and administrative costs in 2008 consist of salaries and consulting costs for thirteen full-time and three part-time people (2007: six full time and three part-time people), office rent and parking, fees to professional service providers, credit facility charges and computer related charges. Gross general and administrative costs increased year over year primarily due to the increased number of employees and the associated expenditures for more personnel and a full year of operations.

During the year ended December 31, 2008, capital expenditure levels were higher, resulting in higher capital recoveries, compared with the prior period which had significantly lower capital activity. During the 2008 year, the Company recovered $861,512 of administrative costs from operated activities compared to $153,555 during 2007.

General and Administrative Costs

	Year ended December 31, 2008	Period ended December 31, 2007
Gross costs	$ **2,534,260**	$ 916,674
Capitalized	**(625,600)**	(399,107)
Recoveries	**(861,512)**	(153,555)
Net costs	$ **1,047,148**	$ 364,012
G&A, per boe	$ **3.76**	$ 39.74

CAPITAL AND OTHER TAXES

Capital and other taxes for 2008 were $332,164. Saskatchewan capital taxes of $227,065 for 2008 are determined as a prescribed percentage of the greater of: (i) the capital employed in the province; and (ii) the sales revenue generated from production in the province. Part XII.6 tax of $105,099 was incurred in 2008 on flow-through funds renounced on a "look-back" basis.

Capital and Other Taxes

	Year ended December 31, 2008	Period ended December 31, 2007
Capital tax	$ 227,065	$ -
Part XII.6 tax	105,099	-
	$ 332,164	$ -

INTEREST AND OTHER INCOME

Painted Pony invests cash in short-term term deposits. These activities generated interest income of $833,838 and $350,227 during 2008 and 2007 respectively. Rentals for the use of tubular pipe for Company-operated fracs generated income of $361,026 and $48,192, respectively during 2008 and 2007. Income from processing and salt water disposal fees totaled $7,838 in 2008.

Interest and Other Income

	Year ended December 31, 2008	Period ended December 31, 2007
Interest income	$ 833,838	$ 350,227
Other income	368,864	48,192
	$ 1,202,702	$ 398,419

DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion expense for operations in 2008 and 2007 was $8,264,740 and $445,508, respectively. In 2008, Painted Pony excluded $nil for the first nine months of 2008 and $11,641,313 in the fourth quarter of the year (2007: $nil) of undeveloped land from the depletion calculation.

Depletion, Depreciation and Accretion Costs

	Year ended December 31, 2008	Period ended December 31, 2007
Depletion	$ 8,123,455	$ 435,473
Depreciation	28,456	7,583
Accretion	112,829	2,452
Total	$ 8,264,740	$ 445,508
Per boe	$ 29.68	$ 48.64

Depletion rates reflect the combined effect of the purchase of the British Columbia assets and the earning of a land position through farm-ins. Depreciation expense of $28,456 (2007: $7,583) was incurred in 2008 to reflect office equipment, computer hardware and software, and office furniture being depreciated on a 20% per annum declining balance basis. Accretion costs were $112,829 in 2008, compared to $2,452, reflecting the higher future retirement liabilities incurred from drilling activities and the Northeast British Columbia property acquisition.

STOCK-BASED COMPENSATION

Stock-based compensation costs in 2008 were $6,110,746 (2007: $nil). The Company capitalized $1,593,443 to oil and gas properties in 2008. The remainder of $4,517,303 was expensed. The stock-based compensation reflects the non-cash costs of the 2,870,000 options granted to purchase Class A shares at an weighted-average price of $5.03 per share, of which generally one-third vested immediately on granting, one-third vests on the one year anniversary of the grant and the final one-third will vest on the two year anniversary of the grant.

CAPITAL EXPENDITURES

The Company incurred non-acquisition capital expenditures of $47,588,700 during 2008 compared to $6,057,508 in 2007. In addition, on March 31, 2008, Painted Pony closed the acquisition of natural gas properties located in Northeast British Columbia for a total cost of $21,161,206, including closing costs and adjustments. During 2008, Painted Pony participated in 50 (21.33 net) wells in Saskatchewan and BC at a net success rate of 86%. In 2007, the Company drilled 6 (2.4 net) wells in Saskatchewan.

In Southeast Saskatchewan in 2008, the Company invested $43.7 million with the drilling of 48 gross (20.3 net) wells. Capital expenditures in Northeast British Columbia, excluding acquisition costs, totaled $3.9 million in 2008.

Capital Expenditures

	Year ended December 31, 2008	Period ended December 31, 2007[(1)]
Lease acquisitions and retention	$ 8,076,324	$ 103,722
Seismic	352,884	-
Drilling and completions	33,066,690	5,285,596
Facilities and equipment	5,954,588	589,895
Head office expenditures	138,214	78,295
Exploration and development	47,588,700	6,057,508
Property acquisition	21,091,103	-
Abandonment expenditures	130,515	-
Stock-based compensation costs and tax effect	2,343,299	-
Asset retirement cost	1,560,460	89,888
Total expenditures	$ 72,714,077	$ 6,147,396

1. For comparative purposes, 2007 data has been summarized to correspond to 2008 data.

The Company has built its land position through drilling to earn land, freehold leasing and acquisitions. The March 16, 2007 farm-out agreement for Saskatchewan properties with Advantage Oil and Gas Ltd. as described in the Company's prospectus dated May 8, 2007 has expired in accordance with its terms. At December 31, 2008, the Company owned 54,000 net acres of developed and undeveloped land (98% undeveloped) in Saskatchewan and 93,900 net developed and undeveloped acres of land (79% undeveloped) in British Columbia.

CEILING TEST

The Company calculates a ceiling test quarterly and annually whereby the carrying amount of petroleum and natural gas properties is compared to estimated future cash flows from the production of proved reserves. In 2008, the ceiling test was performed in accordance with the requirements of the CICA AcG-16 "Oil and Gas Accounting - Full Cost".

The Company performed a ceiling test calculation at December 31, 2008 resulting in undiscounted future cash flows from proved reserves and unproved properties exceeding the carrying amount of oil and gas assets. Consequently, no impairment in oil and gas assets was identified.

At December 31, 2008, the Company calculated the ceiling test using weighted average prices of $86.90/bbl for light gravity crude oil, $8.55/mcf for natural gas, $73.77/bbl for condensate, and $52.31/bbl for NGL's. The future prices used in the ceiling test calculation are based on a benchmark commodity price forecast used by the Company's independent reserve evaluators as follows:

	Edmonton light oil *(C$/bbl)*	B.C. Westcoast Station 2 *(C$/mmbtu)*	Edmonton Pentanes Plus *(C$/bbl)*	Edmonton NGL's *(C$/bbl)*	US/CAN exchange *(US$/CAN$)*
2009	65.35	6.27	66.93	36.92	0.80
2010	72.78	7.01	74.54	39.45	0.85
2011	79.95	7.29	81.88	42.91	0.85
2012	86.57	7.83	88.66	46.37	0.90
2013	94.97	8.65	97.27	50.88	0.95
2014	96.89	8.86	99.23	51.92	0.95
2015	98.85	9.07	101.23	52.98	0.95
2016	100.84	9.28	103.28	54.07	0.95
2017	102.88	9.50	105.36	55.18	0.95
2018	104.96	9.72	107.49	56.31	0.95
2019	107.08	9.95	109.66	57.47	0.95
Thereafter	+ 2%/yr	+ 2%/yr	+ 2%/yr	+ 2%/yr	0.95

Adjustments were made to the benchmark prices for purposes of the ceiling test to reflect varied delivery points and quality differentials in the products delivered.

CAPITAL RESOURCES

At December 31, 2008, Painted Pony had a $17 million demand revolving credit facility and a $5.0 million demand non-revolving acquisition / development facility with a Canadian chartered bank. Interest is payable at the lender's prime rate plus one quarter percent (0.25%) on the demand revolving facility and at the lender's prime rate plus one half percent (0.50%) on the demand non-revolving facility. A standby fee is charged on one eighth of one percent (0.125%) on the undrawn portion of the credit facilities. Security is provided by a first fixed and floating charge debenture of $50 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

The availability under the demand revolving credit facilities was subject to an interim review date of January 31, 2009 and an annual review on or before May 31, 2009. As at December 31, 2008, Painted Pony has no debt under either credit facility. In January, 2009, the bank facilities were reviewed, and no changes were made to the amounts available. The interest rate for the demand revolving credit facility was amended to be payable at the lender's prime rate, subject to adjustment depending on the Company's debt to cash flow ratio. Interest on the non-revolving facility was amended to be payable at the lender's prime rate plus one percent (1.0%). To date, the Company has not drawn on either facility.

SHARE CAPITAL

On May 17, 2007, the Company sold 12,000 units at a price of $1,000 per unit for gross proceeds of $12.0 million (the "Offering"). Each unit was comprised of 400 Class A shares and 90 Class B shares issued on a "flow-through" basis. Share issue costs were $1,046,545.

Subsequent to the closing of the Offering, Painted Pony issued 386,600 Class A shares and 86,985 Class B shares to a third party in satisfaction of the $347,500 convertible debenture and other debt in the amount of $619,000 (the "Debt Satisfaction").

Immediately after the closing of both the Offering and the Debt Satisfaction, a non-brokered private placement (the "Private Placement") was completed for 5,900,000 Class A shares at a price of $0.25 per share to the new Directors, Officers, employees and certain of their associates and affiliates.

In accordance with the policies of the TSXV, the 5,900,000 Class A shares which were issued pursuant to the Private Placement were placed in escrow. Under the terms of the Escrow Agreement, ten percent (10%) of such Class A shares were released from escrow upon receipt of notice from the TSXV confirming the listing of the Class A shares on the TSXV (the "Listing Notice"), which was dated on May 22, 2007. The remaining ninety percent (90%) of such Class A shares were to be released from escrow in fifteen percent (15%) tranches during consecutive six month intervals over the following 36 months, commencing on November 22, 2007. Effective June 20, 2008, the escrow release schedule was accelerated in accordance with NP 46-201 Escrow for Initial Public Offerings and the policies of the TSXV, whereby only 25% of the 5,900,000 Class A shares were in escrow until their release on November 22, 2008. As at December 31, 2008, no Class A shares were in escrow.

On December 6, 2007, the Company completed a private placement of 4,166,700 Class A shares at a price of $2.40 per share on a bought deal private placement basis for total gross proceeds of $10,000,080. Share issue costs were $723,191.

On March 31, 2008, the Company issued 4,110,000 Class A shares at a deemed price of $4.33 per share as partial consideration for an acquisition of producing properties and undeveloped land located in Northeast British Columbia. Transaction costs were $151,544. The Class A share holdings of the vendor (Crescent Point Energy Trust), as of the date of the acquisition, represented approximately 20% of the total issued and outstanding voting shares of the Company.

On April 30, 2008, the Company completed a private placement of 8,800,000 Class A shares at a price of $4.35 per share on a bought deal private placement basis for total gross proceeds of $38,280,000. Share issue costs were $2,433,575.

As at December 31, 2008 and April 1, 2009, 28,222,700 Class A shares and 1,173,600 Class B shares were issued and outstanding. On July 17, 2008, Painted Pony amended its Articles of Incorporation to cancel Common Voting and Common Non-Voting shares. The Company is authorized to issue an unlimited number of Preferred shares, issuable in series. As at December 31, 2008 and April 1, 2009 no Preferred shares were outstanding.

The Company has a Stock Option Plan (the "Plan") whereby options to purchase Class A shares may be granted by the Board of Directors to directors, officers, employees of, and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to ten percent of the aggregate number of Class A shares and Class B shares issued and outstanding from time to time. As at December 31, 2008, 2,840,000 options were issued and outstanding. The options are exercisable over a 5-year period at a weighted-average price of $5.03 per share with generally one-third vesting immediately, one-third vesting one year from date of grant, and one-third vesting two years from date of grant. On April 1, 2009, 2,790,000 options were issued and outstanding at a weighted-average price of $5.00 per share.

INCOME TAXES

On May 17, 2007, the Company issued 12,000 units at $1,000 per unit for total proceeds of $12.0 million, on a flow-through basis, and has committed to spend these funds on qualified exploration and development expenditures by December 31, 2008. In February of 2008, the Company renounced the full $12.0 million effective December 31, 2007. The tax effect of the tax benefits renounced to subscribers was recognized in the consolidated financial statements when the renouncement documents were filed in February, 2008. As at December 31, 2008, the Company has fully satisfied this commitment.

The Company has income tax pools as at December 31, 2008 of approximately $75.8 million including a tax loss carry forward of approximately $3.9 million. The future income tax reduction of $5,477,398 recorded primarily during the first quarter of 2008 relates to the recognition of the income tax effect of the $12.0 million renounced in February 2008 pursuant to the May 2007 flow-through share issuance, the partial recognition of a future tax asset, and the income tax impact of the non-cash stock-based compensation costs capitalized. The Company has recorded a tax asset of $947,542 for the value of these pools as the Company believes that it currently meets the criteria of these losses being utilized being more likely than not. *

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

DIVIDENDS

The Company has not declared or paid any dividends. Any decision to pay dividends on any of its shares will be made by the Board of Directors on the basis of earnings, financial requirements and other conditions existing at such future time.

COMPREHENSIVE INCOME

As Painted Pony does not have any other comprehensive income, the consolidated financial statements do not include a Statement of Comprehensive Income describing the components, nor is a section needed in shareholders' equity, nor is a Statement of Accumulated Other Comprehensive Income presented (which would provide a continuity of the balance).

LIQUIDITY

As at December 31, 2008, Painted Pony had current assets of $26.0 million and current liabilities of $14.1 million. Available cash has been, and is currently, on deposit in term deposits in a major Canadian financial institution. Management has received confirmation from the financial institution that these funds are available on demand.

In 2007, the Company committed to spending $12.0 million on qualifying exploration and development expenditures prior to December 31, 2008 relating to a flow-through agreement, of which the entire amount has been expended as at December 31, 2008.

FOURTH QUARTER

Funds flow from operations during the fourth quarter of 2008 was $2,891,375, an increase of 402% over the fourth quarter of 2007 funds flow from operations of $575,864. In the last quarter of 2008, the Company recorded net earnings of $253,818, primarily as a result of the incremental oil and gas production volumes and interest income, compared to net earnings of $164,855 recorded in the fourth quarter of 2007.

Fourth quarter 2008 cash flow from operating activities was $3,579,139, as compared to 2007 fourth quarter cash flow of $367,765. The Company reconciles funds flow from operation to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP, as follows:

	Three months ended December 31, 2008	Three months ended December 31, 2007
Cash flow from operating activities	$ 3,579,139	$ 367,765
Changes in non-cash working capital	(818,279)	208,099
Asset retirement expenditures	130,515	-
Funds flow from operations	$ 2,891,375	$ 575,864

Sales volumes for the three months ended December 31, 2008 averaged 1,173 boe/d, weighted 55% light oil and liquids and 45% natural gas. In comparison, in the fourth quarter of 2007, Painted Pony averaged 94 bbl/d of light oil.

During the fourth quarter of 2008, revenues were $5,655,781, 660% higher than revenues of $744,092 in the last quarter 2007. For the three months ending December 31, 2008, Painted Pony received an average crude oil price of $60.01/bbl, 30% below the average price of $86.06/bbl received during the comparable 2007 period. The Edmonton par reference price for light oil during the fourth quarter of 2008 and 2007 respectively was $63.75/bbl and $87.18/bbl. In the fourth quarter of 2008, the Company received an average price for gas of $7.26/mcf. There were no gas sales in 2007.

In the fourth quarter of 2008, the Company paid $814,188 in royalties, up 653% from the $108,153 of royalties in the comparable quarter of 2007. As a percentage of sales, royalties were 14.4% during the fourth quarter of 2008, compared to 14.5% in the last quarter of 2007. Fourth quarter 2008 royalty rates were reduced by 1.8% with the recognition of a British Columbia summer drilling credit. In the fourth quarter of 2007, operating costs totaled $53,941 ($6.24/bbl), compared to operating costs in the last quarter of 2008 of $1,116,072 ($10.34/boe). Per unit costs for oil properties increased in 2008 compared to the prior year reflecting harsh winter weather conditions during December combined with general cost increases. During the fourth quarter of 2007, Painted Pony generated field operating netbacks of $62.49/bbl, compared to $28.39/boe in the same quarter of 2008. Crude oil netbacks in the last quarter of 2008 were $36.08/bbl.

In the fourth quarter of 2007, the net general and administrative costs were $144,528 ($16.71/boe), compared to $376,672 ($3.49/boe) in the fourth quarter of 2008. In 2008, the Company was administering a dramatically larger asset base with the significant growth of the organization.

During the fourth quarter of 2007, Painted Pony invested $2.5 million on capital projects. In the comparable 2008 quarter, the Company invested $12.5 million.

Depletion, depreciation, and accretion expense for the fourth quarter of 2007 was $411,009 ($47.53/boe), compared to $2,848,041 ($26.39/boe) in the fourth quarter of 2008.

2008 PERFORMANCE COMPARED TO GUIDANCE AND 2009 OUTLOOK*

The Company continues to evaluate its lands for multi-zone light oil and natural gas potential. In accordance with previously announced guidance, average sales volumes in the fourth quarter of 2008 increased in comparison to the third quarter of 2008 by 27%, the direct result of the active drilling program carried out in both Saskatchewan and British Columbia to date. Production levels in 2009 are expected to show modest growth from fourth quarter production rates, as capital expenditures will be driven by targeting little or no debt.

Currently the Company receives a crude oil price approximately equal to the Edmonton light reference price. In Northeast British Columbia, the Company receives a price for the sale of its natural gas similar to the AECO-C reference price, reflecting the heat content of the gas stream. In the fourth quarter of 2008, the market price for crude oil has decreased dramatically from the prices enjoyed in the third quarter, hence expected per unit sales prices for oil are expected to reduce accordingly. Painted Pony anticipates continued price volatility in 2009.

In accordance with previously announced guidance, an application for royalty relief under a British Columbia provincial incentive program resulted in the Company receiving a $100,000 royalty credit, which was recognized during the fourth quarter of 2008. Management's expectation that fourth quarter royalty rates would approximate the third quarter 2008 rates was realized, prior to recognition of the royalty credit. Additional applications are in the process of being submitted, and if approved, will help offset royalties otherwise due.

During the fourth quarter of 2008 the maximum sales volumes qualifying for reduced royalty rates under the Saskatchewan royalty holiday rules have been reached for a few wells. In accordance with previously announced guidance, royalties from wells which have attained the maximum royalty volumes under the provincial royalty incentive programs have been partially offset by the reduction in royalty costs due to decreased commodity prices. As Painted Pony's operations are focused within Saskatchewan and British Columbia, the Company will not be directly affected by any amendments to Alberta royalty rates.

The Company indicated that it expected fourth quarter operating and transportation costs to continue at approximately the same per unit costs as experienced in the third quarter of 2008. The cost of operating and transporting the Company's products in the fourth quarter increased consistent to costs incurred during the second quarter of the year as the third quarter benefits from summer weather dissipated with the onset of winter. Severe weather could also cause seasonal cost increases combined with production disruptions in 2009. As expected, Northeast British Columbia transportation costs continued to reflect the impact of unutilized firm-service obligations.

Gross general and administrative costs in the fourth quarter of 2008 were expected to be very similar to the third quarter costs. Total costs increased quarter over quarter by 17%. Recoveries of costs through charges to operated capital activities were expected to be lower as the overall capital program was expected to decline as commodity prices soften. Recoveries of costs decreased by 48%, as capital activity during the fourth quarter decreased, reflecting lower commodity prices combined with an increased weighting in partner operated capital activity.

The Company's guidance that fourth quarter Part XII.6 taxes would be minimal was correct. As indicated, as capital tax obligations vary directly with the quantum of Saskatchewan gross sales, these costs decreased during the fourth quarter of 2008. The Company's guidance that interest income would diminish as funds were expended was exacerbated by the fourth quarter reduction in prime rates and hence investment income. Fourth quarter 2008 income expectations from the rental of tubular pipe continued as expected at similar levels to the third quarter of the year. The Company continues to anticipate that in 2009, rentals of tubular pipe income will diminish as operated capital expenditure levels decrease.

The Company previously indicated that it anticipated participating in 4.25 net wells during the fourth quarter of 2008 and 2.7 net wells during the first quarter of 2009. As previously reported, fourth quarter 2008 operations saw Painted Pony participating in 4.2 net wells. Expanded guidance indicated the Company anticipated drilling 2 (1.7 net) horizontal Bakken oil wells and 2 (1.0 net) Bluesky/Gething gas wells during the first quarter of 2009. Currently, the Company expects to drill the two Bakken oil wells 100%, and 1 (0.5 net) Bluesky/ Gething gas wells in the first quarter. In addition, pursuant to two farm-out agreements, two wells targeting the Montney zone on Company lands are currently being drilled. The Company is currently evaluating its 2009 second to fourth quarter budget plans.

Management anticipates that the Company will continue to have adequate liquidity to fund future working capital and capital expenditures through a combination of cash flows, the availability of credit facilities and investment capital. The capital program will be reviewed, and adjusted if necessary based on commodity prices, perceived credit and investment capital availability and share price levels to support the Company's objectives of maintaining a net debt to funds flow from operations ratio of one times or less. At the end of December 2008, the Company had a positive working capital position of $11.8 million and nothing drawn on the two bank credit facilities totaling $22.0 million. It is the Company's objective to maintain its balance sheet in 2009 with little to no debt.

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

COMMITMENTS

The Company's 2007 commitment to spend $12.0 million on qualifying exploration and development expenditures prior to December 31, 2008, pursuant to a flow-through subscription agreement, was fully satisfied by the end of 2008. The Company has no outstanding flow-though obligations.

At December 31, 2008, the Company is committed to the physical delivery of five mmcf per day of natural gas production. The estimated cost of the commitment is:

		Amount
2009	$	675,250
2010		562,400

At December 31, 2008, the Company was committed to future payments totaling $1,542,744 for office space rental and a proportionate share of operating costs through 2013.

OFF BALANCE SHEET ARRANGEMENTS

The Company entered into an arrangement in 2007 with a joint venture partner whereby Painted Pony was carried for approximately $241,627 of land costs incurred by the joint venture partner in exchange for an equivalent value in the drilling of wells by the Company in 2008. This obligation was satisfied during the first quarter of 2008. No off balance sheet arrangements existed as at December 31, 2008.

RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the twelve and three months ended December 31, 2008, the Company incurred $151,243 and $12,782, respectively, on services obtained from the firm.

All related party transactions are in the normal course of business and have been measured at the agreed to terms and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms comparable to those charged to third parties.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The fair values of the Company's term deposits, accounts receivables, accounts payables and accrued liabilities approximate their carrying amounts due to the short-tem nature of these financial instruments.

The Company's accounts receivables are primarily with industry partners and are subject to normal industry credit risks. As the Company extends unsecured credit to these entities, therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities.*

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

To date, the Company has not participated in any hedges or commodity price contracts.

FUTURE ACCOUNTING POLICY CHANGES

Goodwill and Intangible Assets

In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets. Effective for fiscal years beginning on or after October 1, 2008, this section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. Retroactive application to prior-period financial statements will be required. The Company is still assessing the impact of this new standard on its financial statements.

Business Combinations

In January 2009, the CICA issued Section 1582, Business Combinations, and related standards for non-controlling interests and consolidated financial statements. These sections are effective January 1, 2011 and apply prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. These sections replace Section 1581, Business Combinations and harmonize the Canadian standards with IFRS.

International Financial Reporting Standards

In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010.

The International Accounting Standards Board ("IASB") has also issued an exposure draft relating to certain amendments and exemptions to IFRS 1. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment, if implemented, will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company's full cost pool, with the provision that a ceiling test, under IFRS standards, be conducted at the transition date.

Although the amended IFRS 1 standard would provide relief, the changeover to IFRS represents a significant change in accounting standards and the transition from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Company's reported financial position and reported results of operations.

In response, the Company has completed its high-level IFRS changeover plan and established a preliminary timeline for the execution and completion of the conversion project. The changeover plan was determined following a preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS to accounting and reporting processes, information systems, business processes and external disclosures. This assessment has provided insight into what are anticipated to be the most significant areas of difference applicable to the Company.

During the next phase of the project, scheduled to take place during 2009, the Company will perform an in-depth review of the significant areas of difference, identified during the preliminary assessment, in order to identify all specific Canadian GAAP and IFRS differences and select ongoing IFRS policies. Key areas addressed will also be reviewed to determine any information technology issues, the impact on internal controls over financial reporting and the impact on business activities including the effect, if any, on covenants and compensation arrangements. External advisors may be retained to assist management with the project on an as-needed basis. Staff training programs will continue in 2009 and be ongoing as the project unfolds.

The Company will also continue to monitor standards development as issued by the IASB and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators (CSA), which may affect the timing, nature or disclosure of its adoption of IFRS.

BUSINESS RISKS, UNCERTAINTIES AND FORWARD LOOKING INFORMATION

Statements in this document may contain forward-looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, as many may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to the risks associated with the oil and gas industry, commodity prices and exchange rate changes. Industry related risks could include, but are not limited to; operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. These external factors beyond the Company's control may affect the marketability of oil and natural gas produced, industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuations in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward-looking information.

Painted Pony's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Painted Pony is subject to the various types of business risks and uncertainties including:

- *Finding and developing oil and natural gas reserves at economic costs;*
- *Production of oil and natural gas in commercial quantities; and*
- *Marketability of oil and natural gas produced.*

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, Painted Pony combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk plays with high-reward opportunities. Painted Pony also explores in areas where the Company's officers and employees have significant drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, Painted Pony seeks operational control of its projects, where feasible. Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, Painted Pony conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Painted Pony may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management, subject to controls established by the Board of Directors.

CRITICAL ACCOUNTING ESTIMATES

The reader is cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. Estimated reserves are also utilized by Painted Pony's bank in determining credit facilities. Reserves affect net income through depletion, site restoration and abandonment estimates and the ceiling test calculation. Estimating reserves is very complex, requiring many judgments based on available geological, geophysical, engineering and economic data. Changes in these judgments could have a material impact on the estimated reserves. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition of the Company. The "Management's Discussion and Analysis" outlines the accounting policies and practices that are critical to determining Painted Pony's financial results.

In following the liability method of accounting for income taxes, related assets and liabilities are recognized for the estimated tax consequences between amounts included in the financial statements and their tax base, using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly affect the amount of the future income tax liability calculated at a point in time. These differences could materially impact earnings.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because changes in the input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

With the above risks and uncertainties, the reader is cautioned that future events and results may vary substantially from that which the Company currently foresees.

LEGAL, ENVIRONMENTAL REMEDIATION AND OTHER CONTINGENT MATTERS

The Company reviews legal, environmental remediation and other contingent matters to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can reasonably be estimated. When the loss is determined, it is charged to earnings. The Company's management monitors known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstances.

SELECTED CONSOLIDATED QUARTERLY INFORMATION

The following table sets forth selected consolidated financial information of the Company for the most recently completed quarters ending at the fourth quarter of 2008.

Quarter ended *(unaudited) ($)*	Mar 31, 2008	June 30, 2008	Sept 30, 2008	Dec 31, 2008
Gross revenues [1]	**1,354,759**	**6,435,897**	**7,188,501**	**5,655,782**
Funds flow from operations	**1,073,860**	**3,946,823**	**4,845,733**	**2,891,375**
Basic, per share	**0.06**	**0.15**	**0.16**	**0.08**
Diluted, per share	**0.06**	**0.14**	**0.16**	**0.08**
Cash flow from operating activities	**1,314,606**	**2,949,215**	**5,756,112**	**3,579,139**
Net earnings	**3,345,551**	**1,525,544**	**328,233**	**253,818**
Basic and diluted, per share	**0.19**	**0.06**	**0.01**	**0.01**
Capital expenditures, net	**8,894,379**	**10,659,045**	**15,790,485**	**12,244,791**
Capital acquisitions, net	**19,415,563**	**1,605,365**	**55,840**	**14,335**
Total assets	**58,660,444**	**96,362,028**	**100,933,521**	**97,193,946**
Long-term financial liabilities (ARO) [2]	**1,656,273**	**1,833,999**	**1,996,268**	**1,765,629**

1. Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
2. Asset retirement obligation.

Quarter ended *(unaudited) ($)*	June 30, 2007	Sept 30, 2007	Dec 31, 2007
Gross revenues [1]	-	38,751	744,092
Funds flow (used in) from operations	(52,793)	79,885	575,864
Basic and diluted, per share	(0.01)	0.00	0.04
Cash flow from (used in) operating activities	(141,693)	(59,524)	367,763
Net earnings (loss)	(53,661)	46,254	164,855
Basic and diluted, per share	(0.01)	0.00	0.01
Capital expenditures, net	497,615	3,027,516	2,532,377
Capital acquisitions, net	-	-	-
Total assets	13,865,033	17,054,020	26,194,023
Long-term financial liabilities (ARO) [2]	5,081	26,954	92,340

1. Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
2. Asset retirement obligation.

SELECTED CONSOLIDATED ANNUAL INFORMATION

Period ended December 31, ($)	2008	2007
Gross revenues [1]	**20,634,939**	782,843
Funds flow from operations	**12,757,791**	602,956
Basic and diluted, per share	**0.38**	0.07
Cash flow from operating activities	**13,599,073**	166,548
Net earnings	**5,453,146**	157,448
Basic and diluted, per share	**0.16**	0.02
Capital expenditures, net	**47,588,700**	6,057,508
Capital acquisitions, net	**21,091,103**	-
Total assets	**97,193,946**	26,194,023
Long-term financial liabilities (ARO) [2]	**1,765,629**	92,340

1. Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
2. Asset retirement obligation.

READER ADVISORY

Statements in this document may contain forward-looking information including expectations of future production and components of funds flow and earnings. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to; the risks associated with the oil and gas industry, commodity prices and exchange rate changes. Industry related risks could include, but are not limited to; operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. The reader is cautioned not to place undue reliance on this forward-looking information.

The reader is further cautioned that the preparation of consolidated financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes.

Management's Responsibility for Consolidated Financial Statements

The management of Painted Pony Petroleum Ltd. (the "Company") is responsible for the preparation and integrity of the accompanying consolidated financial statements and all other information contained in this report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada and include amounts that are based on management's informed judgments and estimates where necessary.

The Company has established internal accounting control systems which are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of the consolidated financial statements together with the other financial information for external purposes in accordance with Canadian GAAP.

The Board of Directors, through its Audit Committee, monitors management's financial and accounting policies and practices and the preparation of these consolidated financial statements. The Audit Committee meets periodically with the external auditors and management to review the work of each and the propriety of the discharge of their responsibilities.

The Audit Committee reviews the consolidated financial statements of the Company with management and the external auditors prior to submission to the Board of Directors for final approval. The Board of Directors also review the consolidated financial statements before they are finalized. The external auditors have full and free access to the Audit Committee to discuss auditing and financial reporting matters. The Audit Committee reviews the independence of the external auditors and pre-approves audit and permitted non-audit services and fees. The Shareholders have appointed KPMG LLP as the external auditors of the Company, and in that capacity, they have audited the consolidated financial statements for the year ended December 31, 2008 and the period ended December 31, 2007.

Patrick R. Ward	Joan E. Dunne
President and CEO	*Vice President, Finance and CFO*

April 1, 2009

Auditors' Report

To the Shareholders of Painted Pony Petroleum Ltd.

We have audited the consolidated balance sheets of Painted Pony Petroleum Ltd. as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive income, and retained earnings (deficit) and cash flows for the year ended December 31, 2008 and the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the year ended December 31, 2008 and the period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

KPMG LLP
Chartered Accountants
Calgary, Canada

April 1, 2009

Consolidated Balance Sheets

As at December 31,		2008		2007
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**19,792,514**	$	17,349,245
Accounts receivable		**5,822,755**		3,075,578
Prepaid expenses and deposits		**364,629**		64,860
		25,979,898		20,489,683
Long-term assets				
Property and equipment *(notes 5 and 6)*		**70,266,506**		5,704,340
Future income tax *(note 13)*		**947,542**		-
	$	**97,193,946**	$	26,194,023
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Accounts payable and accrued liabilities	**$**	**14,145,283**	$	4,238,890
Long-term liabilities				
Asset retirement obligations *(note 8)*		**1,765,629**		92,340
		15,910,912		4,331,230
Shareholders' equity				
Capital stock *(note 9)*		**70,644,240**		22,709,345
Contributed surplus *(note 10)*		**6,032,200**		-
Retained earnings (deficit)		**4,606,594**		(846,552)
		81,283,034		21,862,793
	$	**97,193,946**	$	26,194,023

Basis of presentation *(note 2)*
Commitments *(note 15)*

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

Arthur Madden
Director

Patrick R. Ward
Director

Consolidated Statements of Operations, Comprehensive Income and Retained Earnings (Deficit)

	Year ended December 31, 2008	Period ended December 31, 2007
Revenue		
Petroleum and natural gas	$ 20,634,939	$ 782,843
Royalties	(3,298,182)	(112,285)
Interest	833,838	350,227
Other	368,864	48,192
	18,539,459	1,068,977
Expenses		
Operating	2,529,304	58,609
Transportation	1,873,052	43,400
General and administrative	1,047,148	364,012
Capital and other taxes	332,164	-
Stock-based compensation *(note 9)*	4,517,303	-
Depletion, depreciation and accretion	8,264,740	445,508
	18,563,711	911,529
Income (loss) before income taxes	(24,252)	157,448
Future income tax reduction *(note 13)*	5,477,398	-
Net income and comprehensive income for the period	5,453,146	157,448
Deficit, beginning of period	(846,552)	(1,004,000)
Retained earnings (deficit), end of period	$ 4,606,594	$ (846,552)
Net income per share *(note 11)*		
Basic and diluted	$ 0.16	$ 0.02

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

	Year ended December 31, 2008	Period ended December 31, 2007
Cash provided by (used in)		
Operating activities		
Net income for the period	$ 5,453,146	$ 157,448
Items not affecting cash:		
Stock-based compensation	4,517,303	-
Depletion, depreciation, and accretion	8,264,740	445,508
Future income tax reduction	(5,477,398)	-
	12,757,791	602,956
Asset retirement expenditures	(130,515)	-
Change in non-cash working capital *(note 12)*	971,797	(436,408)
	13,599,073	166,548
Financing activities		
Issuance of share capital	38,399,100	23,475,080
Share issuance costs	(2,504,051)	(1,769,736)
Change in non-cash working capital *(note 12)*	105,099	-
	36,000,148	21,705,344
Investing activities		
Expenditures on property and equipment additions	(47,588,700)	(6,057,508)
Expenditures on property and equipment acquisitions	(5,349,803)	-
Change in non-cash working capital *(note 12)*	5,782,551	1,534,861
	(47,155,952)	(4,522,647)
Change in cash and cash equivalents	2,443,269	17,349,245
Cash and cash equivalents, beginning of period	17,349,245	-
Cash and cash equivalents, end of period	$ 19,792,514	$ 17,349,245
Cash and cash equivalents is comprised of:		
Balances with banks	$ 792,514	$ 49,245
Short term deposits	19,000,000	17,300,000
	$ 19,792,514	$ 17,349,245

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

Year ended December 31, 2008 and period ended December 31, 2007

1. NATURE OF OPERATIONS

Painted Pony Petroleum Ltd.'s (the "Company") principal business activity is the exploration, development and production of petroleum and natural gas resources in western Canada.

2. BASIS OF PRESENTATION

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. These consolidated financial statements include the accounts of Painted Pony Petroleum Ltd. and its wholly-owned subsidiary, Painted Pony Petroleum Corporation.

The Company commenced commercial operations on April 3, 2007 upon completion of the financial reorganization (see note 4). Consequently, comparative financial information for the statements of operations and cash flows represents the period April 3, 2007 to December 31, 2007.

3. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenue and expenses during the period. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below. Actual results could differ from those estimates.

Property and Equipment

(i) Capitalized Costs
The Company follows the Canadian full cost method of accounting for its petroleum and natural gas operations. Under this method, all costs related to the exploration, development and production of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, production equipment costs, general and administrative costs and stock-based compensation directly related to exploration and development activities. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion by more than 20%. Office equipment and furniture and fixtures are recorded at cost.

(ii) Depletion and Depreciation
Petroleum and natural gas properties, including estimated costs of future development of proved undeveloped reserves are depleted and amortized using the unit-of-production method based on estimated gross proved petroleum and natural gas reserves as determined by independent engineers. For depletion and amortization purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Year ended December 31, 2008 and period ended December 31, 2007

Costs of unproved properties and seismic costs on undeveloped land are initially excluded from petroleum and natural gas properties for the purpose of calculating depletion. When proved reserves are assigned, or the property or seismic is considered to be impaired, the costs of the property or seismic or the amount of the impairment is added to costs subject to depletion.

Furniture, fixtures, and office equipment are depreciated over their estimated useful life at a declining-balance rate of 20%.

(iii) Ceiling Test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of carrying amount, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. The Company's risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

Asset Retirement Obligations

The Company recognizes the fair value of an Asset Retirement Obligation ("ARO") in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value is determined through a review of engineering studies, industry guidelines and management's estimate on a site-by-site basis. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on gross proved reserves. The liability amount is increased each reporting period to reflect the passage of time with the corresponding amount charged to earnings as accretion expense. Actual costs incurred upon the settlement of the asset retirement obligation are charged against the asset retirement obligations to the extent of the liability recorded.

Joint Operations

Substantially all of the exploration and production activities of the Company are conducted jointly with others and these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax basis. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the assets will not be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the date of substantive enactment.

Flow-Through Shares

Periodically, the Company may finance a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. Share capital is reduced and the future tax liability is increased by the tax effected amount of the renounced tax deductions at the time of renouncement, which is when the related documentation is filed with the appropriate governmental agency and there is reasonable certainty that the expenditures will be incurred.

Stock-Based Compensation

The Company accounts for stock option agreements using the fair value method. Under this method, the fair value of the stock options, measured at the grant date, is charged to operations over the vesting period, with a corresponding increase in contributed surplus. Upon exercise of the stock options, consideration paid by the option holder, together with the amount recognized in contributed surplus, is credited to share capital.

Revenue Recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids are recognized based on volume delivered at contractual delivery points and rates. The cost associated with the delivery, including operating, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Per Share Amounts

Basic earnings per share is computed by dividing net income by the weighted average number of Class A and Class B common shares outstanding during the period. In addition, Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Market Price, defined as the weighted average trading price per share of the Class A shares for the last 30 consecutive trading days as of the balance sheet date. The treasury stock method is used to calculate diluted per share amounts whereby proceeds from the exercise of in-the-money stock options and unrecognized future stock-based compensation expense are assumed to be used to purchase common shares of the Company at the average market price during the period. Diluted per share amounts reflect the potential dilution that could occur if stock options to purchase common shares were exercised and converted to common shares.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents. These cash equivalents primarily consist of funds on deposit under various terms.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and the ceiling test calculation are based on estimates of gross proved reserves, as determined by independent engineers, production rates, commodity prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effects on the consolidated financial statements of changes in such estimates in future years could be significant.

The value of the asset retirement obligations was based on the Company's net ownership interests in all wells and facilities, and depends on estimates of current market interest rates, inflation rates, and future restoration and reclamation expenditures. By their nature, these estimates are subject to measurement uncertainty and the effect of changes of estimates on the consolidated financial statements in future periods could be significant.

The calculation of future income tax is based on assumptions, which are subject to uncertainty as to timing as well as the tax rates at which temporary differences are expected to reverse.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because changes in the input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

Accounting Changes

Accounting changes are applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

Comprehensive Income

Comprehensive income includes unrealized gains and losses, such as changes in currency translation adjustment relating to self-sustaining foreign operations, unrealized gains or losses on available-for-sale investments and the effective portion of gains or losses on derivatives designated as cash flow hedges. For the periods presented, comprehensive income is the same as net income.

Financial Instruments

All financial instruments are classified into one of the following five categories: held-for-trading (cash and cash equivalents), held-to-maturity (none), loans and receivables (accounts receivable), available-for-sale financial assets (none), and other financial liabilities (accounts payable and accrued liabilities). Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification.

- *Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net income.*

- *Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet.*

- *Held for trading financial instruments are measured at fair value. All gains and losses are included in the net income in the period in which they arise.*

- *All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses are included in net income in the period which they arise.*

Year ended December 31, 2008 and period ended December 31, 2007

Changes in Accounting Policies

On January 1, 2008, the Company adopted the new accounting standard, "Capital Disclosures", which establishes the standards for disclosing information about an entity's objectives, policies and processes for how it manages its capital. A company must also disclose qualitative data about what the entity regards as capital, and whether the company has complied with any capital requirements and, if not, the consequences of such non-compliance (see note 16).

The Company also adopted, on January 1, 2008, two new accounting standards for financial instruments, "Financial Instruments - Disclosures", and "Financial Instruments - Presentation". These accounting standards replaced "Financial Instruments - Disclosure and Presentation".

The accounting standard, "Financial Instruments - Disclosures", describes the required disclosures to evaluate the significance of financial instruments for the entity's financial position and performance, as well as, the nature and extent of risks arising from both recognized and unrecognized financial instruments to which the entity is exposed and how the entity manages those risks (see note 17).

The accounting standard, "Financial Instruments - Presentation", establishes standards for presentation of financial instruments and non-financial derivatives (see note 17).

Future Changes in Accounting Policies

(i) Goodwill and intangible assets
In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets. Effective for fiscal years beginning on or after October 1, 2008, this section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. Retroactive application to prior-period financial statements will be required. The Company is still assessing the impact of this new standard on its financial statements.

(ii) Business combinations
In January 2009, the CICA issued Section 1582, Business Combinations, and related standards for non-controlling interests and consolidated financial statements. These sections are effective January 1, 2011 and apply prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. These sections replace Section 1581, Business Combinations and harmonize the Canadian standards with IFRS.

(iii) International financial reporting standards
In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010.

The International Accounting Standards Board ("IASB") has also issued an exposure draft relating to certain amendments and exemptions to IFRS 1. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment, if implemented, will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company's full cost pool, with the provision that a ceiling test, under IFRS standards, be conducted at the transition date.

Year ended December 31, 2008 and period ended December 31, 2007

Although the amended IFRS 1 standard would provide relief, the changeover to IFRS represents a significant change in accounting standards and the transition from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Company's reported financial position and reported results of operations. In response, the Company has completed its high-level IFRS changeover plan and established a preliminary timeline for the execution and completion of the conversion project. The changeover plan was determined following a preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS to accounting and reporting processes, information systems, business processes and external disclosures. This assessment has provided insight into what are anticipated to be the most significant areas of difference applicable to the Company.

During the next phase of the project, scheduled to take place during 2009, the Company will perform an in-depth review of the significant areas of difference, identified during the preliminary assessment, in order to identify all specific Canadian GAAP and IFRS differences and select ongoing IFRS policies. Key areas addressed will also be reviewed to determine any information technology issues, the impact on internal controls over financial reporting and the impact on business activities including the effect, if any, on covenants and compensation arrangements. External advisors may be retained to assist management with the project on an as-needed basis. Staff training programs will continue in 2009 and be ongoing as the project unfolds.

The Company will also continue to monitor standards development as issued by the IASB and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators (CSA), which may affect the timing, nature or disclosure of its adoption of IFRS.

4. FINANCIAL REORGANIZATION

Effective March 20, 2007, the Company's debt and equity holders approved a financial reorganization, as part of an overall restructuring of the Company.

The Company's assets and liabilities have been adjusted to reflect the values established during the financial reorganization. The contributed surplus and the original share capital have been reclassified to deficit, and the Company commenced operations as of the date after the financial reorganization. The effect of the financial reorganization on the balance sheet accounts is as follows:

	March 20, 2007 prior to financial reorganization	Reorganization adjustments	March 20, 2007 after financial reorganization
ASSETS	$ -	$ -	$ -
LIABILITIES AND SHAREHOLDERS' EQUITY			
Due to StoneBridge Merchant Capital Corp.	550,909	68,091 [(a)]	619,000
Convertible debentures	347,500	-	347,500
Common shares	42,500	(5,000) [(b)]	37,500
Contributed surplus	15,690,266	(15,690,266) [(c)]	-
Deficit	(16,631,175)	15,627,175 [(c)]	(1,004,000)
	$ -	$ -	$ -

(a) To reflect the agreed upon fair value of the debt.
(b) To eliminate share capital attributable to previously issued common shares.
(c) Reclassification of contributed surplus to deficit to reflect fresh start accounting as of the date of the financial reorganization.

On April 3, 2007, the Company:

- *changed its name from 1300873 Alberta Ltd. to Painted Pony Petroleum Ltd.;*
- *authorized an unlimited number of Class A shares;*
- *authorized an unlimited number of Class B shares convertible at the option of the Company at any time after June 30, 2010 and before June 30, 2012, and convertible at the option of the holder after July 1, 2012 and before August 1, 2012, into Class A shares. Any outstanding Class B shares at August 1, 2012 shall be automatically converted into Class A shares;*
- *authorized an unlimited number of common voting shares;*
- *authorized an unlimited number of common non-voting shares, redeemable at the option of the holder;*
- *authorized an unlimited number of preferred shares issuable in series from time to time to be determined by the directors; and*
- *changed the 196 issued and outstanding common voting shares into:*
    - *(i) 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting shares, and*
    - *(ii) 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.*

On July 17, 2008, the Company removed common voting and common non-voting shares from its share structure through filing amended Articles of Incorporation.

5. PROPERTY ACQUISITION

On March 31, 2008, the Company completed the acquisition of certain natural gas properties in northeast British Columbia ("the Assets"). The acquisition was accounted for at $3.83 per share for the 4,110,000 Class A shares of the Company issued and $5.3 million cash and transaction costs, for a total purchase price of $21.2 million.

The following table summarizes the estimated fair value of the Assets acquired at the date of acquisition.

Consideration:		
Issue of 4,110,000 Class A shares	$	15,741,300
Cash		5,268,362
Transaction costs		151,544
Total consideration	$	21,161,206
Allocated to:		
Property and equipment	$	22,725,312
Asset retirement obligations		(1,564,106)
	$	21,161,206

The above amounts are estimates made by management based on currently available information. Revisions may be made to the purchase equation as cost estimates and balances are finalized.

Year ended December 31, 2008 and period ended December 31, 2007

6. PROPERTY AND EQUIPMENT

December 31, 2008	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	**$ 78,644,964**	**$ 8,558,928**	**$ 70,086,036**
Other	**216,509**	**36,039**	**180,470**
	$ 78,861,473	**$ 8,594,967**	**$ 70,266,506**

December 31, 2007	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	$ 6,069,101	$ 435,473	$ 5,633,628
Other	78,295	7,583	70,712
	$ 6,147,396	$ 443,056	$ 5,704,340

The Company has included $12,925,000 (2007: $3,823,200) for future development costs and excluded $11,641,313 (2007: $nil) for undeveloped land from the depletion calculation and the ceiling test.

For the year ended December 31, 2008 and the period ended December 31, 2007, the Company capitalized general and administrative expenses and stock-based compensation as follows:

	Year ended December 31, 2008	Period ended December 31, 2007
General and administrative	**$ 625,600**	$ 399,107
Stock-based compensation	**1,593,443**	-
Total	**$ 2,219,043**	$ 399,107

The Company performed a ceiling test calculation at December 31, 2008 and determined there was no impairment of its petroleum properties. The future prices used in the ceiling test calculation are based on a benchmark commodity price forecast used by the Company's independent reserve evaluators as follows:

	Edmonton light oil (US$/bbl)	B.C. Westcoast Station 2 (US$/mmbtu)	Edmonton Pentanes Plus (C$/bbl)	Edmonton NGL's (C$/bbl)	US/CAN exchange (US$/CAN$)
2009	65.35	6.27	66.93	36.92	0.80
2010	72.78	7.01	74.54	39.45	0.85
2011	79.95	7.29	81.88	42.91	0.85
2012	86.57	7.83	88.66	46.37	0.90
2013	94.97	8.65	97.27	50.88	0.95
2014	96.89	8.86	99.23	51.92	0.95
2015	98.85	9.07	101.23	52.98	0.95
2016	100.84	9.28	103.28	54.07	0.95
2017	102.88	9.50	105.36	55.18	0.95
2018	104.96	9.72	107.49	56.31	0.95
2019	107.08	9.95	109.66	57.47	0.95
Thereafter	+ 2%/yr	+ 2%/yr	+ 2%/yr	+ 2%/yr	0.95

Adjustments were made to the benchmark prices for purposes of the ceiling test to reflect varied delivery points and quality differentials in the products delivered.

7. BANK DEBT

At December 31, 2008 and 2007, the Company had no bank debt. The Company has available a $17 million demand revolving credit facility and a $5 million demand non-revolving acquisition / development facility with a Canadian chartered bank. Security is provided by a first fixed and floating charge demand debenture of $50 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances. Interest is payable at the lender's prime rate plus 0.25% on the demand revolving facility and at the lender's prime rate plus 0.50% on the demand non-revolving facility. A standby fee is charged on 0.125% on the undrawn portion of the credit facilities. The availability under the demand revolving credit facility was subject to an interim review date of January 31, 2009 and an annual review on or before May 31, 2009.

In January, 2009, the bank line was reviewed. The interest rate for the demand revolving credit facility was amended to be payable at a floating rate determined as the lender's prime rate plus between 0.25% and 2.5%, depending on the Company's debt to cash flow ratio. Interest on the non-revolving facility was amended to be payable at the lender's prime rate plus 1.0%. The standby fee on the undrawn portion of the demand revolving credit facility was amended to be payable at a floating rate between 0.25% and 0.50%, depending on the Company's debt to cash flow ratio.

Year ended December 31, 2008 and period ended December 31, 2007

8. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the Company's net ownership in wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated the total undiscounted asset retirement obligations to be $6.2 million as at December 31, 2008 (December 31, 2007: $0.2 million). These payments are expected to be made over the next 29 years, with the majority estimated to be spent between 2026 and 2028. The Company used a credit-adjusted risk-free rate of 8% and an inflation rate of 2% to calculate the present value of the asset retirement obligations.

The following table reconciles the Company's asset retirement obligations:

	Year ended December 31, 2008	Period ended December 31, 2007
Obligations, beginning of period	$ 92,340	$ -
Liabilities incurred	362,175	89,888
Revisions	(235,306)	-
Abandonments	(130,515)	-
Liabilities acquired on property acquisition *(see note 5)*	1,564,106	-
Accretion expensed	112,829	2,452
Obligations, end of period	$ 1,765,629	$ 92,340

9. CAPITAL STOCK

a) Authorized

Unlimited Class A shares
Unlimited Class B shares
Unlimited Preferred shares, issuable in series, none outstanding as at December 31, 2008 and 2007

The Class A shares and the Class B shares are voting on the basis of one vote per share. There are no fixed dividends payable on either the Class A shares or the Class B shares. In the event of the liquidation or dissolution of the Company, the Class B shares will be converted at the conversion rate (further discussed under "Class B shares") into Class A shares and the Class A shares are entitled to receive, on a pro rata basis, all assets of the Company as are distributable to the holders of shares.

The Class B shares will be convertible, at the option of the Company, at any time after June 30, 2010 and on or before June 30, 2012 into Class A shares. The number of Class A shares obtained upon conversion of each Class B share will be equal to $10.00 divided by the greater of $1.00 and the Current Trading Price (as defined - see note 11) of the Class A shares at the balance sheet date.

If the conversion has not occurred by the close of business on June 30, 2012, the Class B shares become convertible, at the option of the shareholder, into Class A shares on the same basis. Any Class B shares outstanding at the close of business on August 1, 2012 shall be automatically converted into Class A shares on the same basis.

b) Issued and Outstanding

Common Voting Shares

	Period ended December 31, 2007	
	Number of Shares	Amount
Balance, beginning of period	100	$ 5,000
Shares issued	96	37,500
Financial reorganization	-	(5,000)
April 3, 2007 prior to financial reorganization	196	37,500
Exchange into Class A and Class B shares	(196)	(37,500)
Balance, after financial reorganization	-	$ -

Class A and Class B Shares

	Class A shares		Class B shares	
	Number of shares	Amount	Number of shares	Amount
Common voting shares exchanged into Class A and Class B shares pursuant to the financial reorganization	29,400	$ 3,750	6,615	$ 33,750
Flow-through shares issued	4,800,000	1,200,000	1,080,000	10,800,000
Shares issued in satisfaction of debt	386,600	96,650	86,985	869,850
Private placement to founders	5,900,000	1,475,000	-	-
Private placement	4,166,700	10,000,080	-	-
Share issuance costs, allocated	-	(827,845)	-	(941,890)
Balance, December 31, 2007	15,282,700	11,947,635	1,173,600	10,761,710
Shares issued for asset acquisition *(note 5)*	4,110,000	15,741,300	-	-
Private placement	8,800,000	38,280,000	-	-
Options exercised	30,000	119,100	-	-
Transfer from contributed surplus on exercise of options	-	78,546	-	-
Share issuance costs	-	(2,504,051)	-	-
Income tax effect of flow-through share renouncement, allocated	-	(378,000)	-	(3,402,000)
Balance, December 31, 2008	28,222,700	$ 63,284,530	1,173,600	$ 7,359,710

On January 31, 2007, 96 common shares were issued for cash consideration of $37,500 pursuant to a private placement.

On February 2, 2007, by Articles of Amendment, the Company created an unlimited number of non-voting common shares and consolidated the issued common shares on the basis that up to 2,500 of such shares shall become one common share. All share and per share amounts have been retroactively adjusted to reflect this share consolidation.

Effective April 3, 2007 pursuant to the financial reorganization, the 196 issued and outstanding common voting shares were exchanged for:

(i) 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting shares, and

(ii) 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.

On May 17, 2007, the Company issued 12,000 units at a price of $1,000 per unit for gross proceeds of $12,000,000 (the "Offering"). Each unit is comprised of 400 Class A shares and 90 Class B shares issued on a "flow-through" basis. The Company was committed to spend these funds on qualified exploration and development expenditures by December 31, 2008. In February 2008, the Company renounced the full $12,000,000 effective December 31, 2007. The tax effect of the tax benefits renounced to subscribers was recognized in the consolidated financial statements in February 2008 when the renouncement documents were filed. As at December 31, 2008, the Company had satisfied all commitments related to this financing.

During 2007, the Company issued 386,600 Class A shares and 86,985 Class B shares in satisfaction of the convertible debenture in the amount of $347,500 and other debt in the amount of $619,000 (the "Debt Satisfaction"). In addition, a non-brokered private placement (the "Private Placement") was completed of 5,900,000 Class A shares at a price of $0.25 per share to the new Directors, Officers, employees and certain of their associates and affiliates.

On December 6, 2007, the Company completed a bought deal private placement of 4,166,700 Class A shares at a price of $2.40 per share for gross proceeds of $10,000,080.

On March 31, 2008, the Company issued 4,110,000 Class A shares at a deemed price of $4.33 per share as partial consideration for an acquisition of producing properties and undeveloped land located in Northeast British Columbia. Transaction costs were $151,544.

On April 30, 2008, the Company completed a private placement of 8,800,000 Class A shares at a price of $4.35 per share on a bought deal private placement basis for total gross proceeds of $38,280,000. Share issue costs were $2,433,575.

On July 17, 2008, Painted Pony removed Common Voting and Common Non-Voting shares from its share structure through filing amended Articles of Incorporation.

a) Stock Option Plan

The Company has a Stock Option Plan (the "Plan") pursuant to which options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, employees of, and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to 10% of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time.

As at December 31, 2008, 2,840,000 options (December 31, 2007: nil) are issued and outstanding, at an average exercise price of $5.03 and with a weighted-average life of 4.3 years. A total of 942,666 of the options granted are vested and the remainder vest in equal tranches on the first and second anniversaries of the date of grant. The options expire 5 years from date of grant.

The following tables summarize information regarding stock options for the year ended December 31, 2008:

		Weighted average exercise price	Number
Balance, December 31, 2007		-	-
Granted	$	5.02	2,870,000
Exercised	$	3.97	(30,000)
Balance, December 31, 2008	$	5.03	2,840,000

Stock Options, December 31, 2008

Number of options outstanding	Exercise price	Weighted average remaining life (years)	Exercisable options
1,317,000	$3.97	4.1	429,000
1,090,000	$6.68	4.5	369,333
205,000	$5.00	4.7	68,333
153,000	$4.15	4.7	51,000
75,000	$1.40	4.9	25,000
2,840,000	$5.03	4.3	942,666

d) Stock-Based Compensation

The Company accounts for its stock options granted to employees, consultants, officers, and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have an exercise price equal to the fair value of the security at the date of grant. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions have been used:

		Year ended December 31, 2008
Fair value per option (weighted average)	$	3.17
Risk free rate *(%)*		3.13
Expected life *(years)*		5
Expected volatility *(%)*		80
Expected dividends		-

No stock options were granted in 2007.

10. CONTRIBUTED SURPLUS

		Year ended December 31, 2008
Balance, December 31, 2007	$	-
Stock-based compensation *(see note 9(d))*		6,110,746
Transfer to share capital on exercise of options		(78,546)
Balance, December 31, 2008	$	6,032,200

For the year ended December 31, 2008, the Company recorded $6,110,746 (2007: $nil) of compensation cost related to stock options issued during the period. During the year ended December 31, 2008, $1,593,443 (2007: $nil) was capitalized to oil and gas properties and $4,517,303 (2007: $nil) was expensed.

Year ended December 31, 2008 and period ended December 31, 2007

11. PER SHARE AMOUNTS

The weighted average number of Class A and Class B shares outstanding during the year ended December 31, 2008 and the period ended December 31, 2007 was as follows:

Weighted average shares	Year ended December 31, 2008	Period ended December 31, 2007
Class A - basic	**24,313,807**	7,280,725
Class A - diluted	**24,411,066**	7,280,725
Class B - basic	**1,173,600**	738,512
Class B - deemed conversion to Class A	**9,187,412**	1,981,358
Class A & B - basic	**33,501,219**	9,262,083
Class A & B -diluted	**33,598,478**	9,262,083

During the year ended December 31, 2008, 1,553,000 (2007: nil) options were excluded in the weighted-average diluted share calculation of Class A shares. Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Trading Price, defined as being the weighted-average trading price per share of Class A shares for the last 30 consecutive trading days.

12. CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31, 2008	Period ended December 31, 2007
Accounts receivable	**$ (2,747,177)**	$ (3,075,577)
Prepaid expenses and deposits	**(299,769)**	(64,860)
Accounts payable and accrued liabilities	**9,906,393**	4,238,890
	$ 6,859,447	$ 1,098,453

The change in non-cash working capital has been allocated to the following activities:

	Year ended December 31, 2008	Period ended December 31, 2007
Operating	**$ 971,797**	$ (436,408)
Financing	**105,099**	-
Investing	**5,782,551**	1,534,861
	$ 6,859,447	$ 1,098,453

13. INCOME TAX

The provision for income tax differs from that which would be obtained from applying the combined Canadian federal and provincial income tax rate to net income before income tax. The difference results from the following:

	Year ended December 31, 2008	Period ended December 31, 2007
Income (loss) before income taxes	$ (24,252)	$ 157,448
Combined corporate tax rate	31.61%	35.62%
Computed "expected" income tax expense (reduction)	(7,666)	56,083
Non-deductible expenses	8,711	5,104
Stock-based compensation	1,427,705	-
Change in valuation allowance	(6,774,584)	(654,999)
Change in tax rates	(131,564)	588,938
Other	-	4,874
Income tax reduction	$ (5,477,398)	$ -

The components of the Company's future income tax assets/(liability) are as follows:

	As at December 31, 2008	As at December 31, 2007
Non-capital losses	$ 1,176,481	$ 4,352,500
Property and equipment	(410,335)	1,650,781
Share issue costs	888,127	430,046
Asset retirement obligations	472,208	24,932
	2,126,481	6,458,259
Less: valuation allowance	(1,178,939)	(6,458,259)
	$ 947,542	$ -

At December 31, 2008, the Company had a non-capital loss of approximately $3.9 million, expiring in varied amounts over the next 19 years, but primarily the next two years, which may be applied to reduce future years' taxable income.

14. RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the year ended December 31, 2008, the Company incurred $151,243 (2007: $186,834) on services obtained from the firm. As at December 31, 2008, the Company owes this related party $9,305.20.

For the period ended December 31, 2007, a family member of the President provided computer consulting services entered into on normal commercial terms for $2,302.

All related party transactions are in the normal course of business and have been valued at the agreed to terms and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms comparable to those negotiated with third parties.

Year ended December 31, 2008 and period ended December 31, 2007

15. COMMITMENTS

a) At December 31, 2008, the Company is committed to the physical delivery of five mmcf per day of natural gas production. The estimated remaining cost of the commitment is:

		Amount
2009	$	675,250
2010	$	562,400

b) At December 31, 2008, the Company was committed to future payments for office space rental and a proportionate share of operating costs through 2013 as follows:

		Amount
2009	$	342,832
2010		342,832
2011		342,832
2012		342,832
2013		171,416
Total	$	1,542,744

16. CAPITAL DISCLOSURES

At December 31, 2008, the Company considers its capital structure to include shareholders' equity, working capital, and available credit facilities. The Company will adjust its capital structure to manage any projected deficiencies of working capital through the issuance of shares, the use of available credit facilities, and/or adjusting its capital spending. The Company monitors its capital spending program based on the current and projected ratios of net debt to funds flow.

The Company's objectives in managing its capital structure are to:

a) Create and maintain flexibility to enable the Company to continue to meet its financial obligations; and

b) Finance its growth either through internally generated projects, joint interest relationships or asset / corporate acquisitions.

The Company monitors its capital structure using primarily the non-GAAP financial measure of net debt to annualized funds flow from operations ratio. The Company's objective is to maintain a net debt to funds flow from operations ratio of one times or less. To facilitate the management of this ratio, the Company prepares an annual budget, which is updated as required throughout the year for any significant acquisition, a change in economic circumstances outside the control of the Company, and success or failure of capital deployed. Each of the annual budgets and periodic updates are approved by the Board of Directors. As at December 31, 2008, the Company had no debt and had positive working capital of $11.8 million as detailed below:

		As at December 31, 2008
Current assets	$	25,979,898
Current liabilities		(14,145,283)
Net working capital	$	11,834,615

Year ended December 31, 2008 and period ended December 31, 2007

The Company is required to maintain a minimum working capital ratio of 1:1 to remain in compliance with its credit facility. For purposes of this calculation, working capital ratio is defined as the ratio of current assets plus any undrawn availability under the revolving credit facility to current liabilities less any amount drawn under the credit facilities. At December 31, 2008, the Company had a working capital ratio of 3:1, which is greater than the minimum ratio required.

17. FINANCIAL INSTRUMENTS

Management has primary responsibility for monitoring and managing financial instrument risks under direction from the Board of Directors which has overall responsibility for establishing the Company's risk management framework. In certain circumstances, for example, price fixing of future production revenue, the Board has established policies and has established risk limits and controls and monitors these risks in relation to market conditions. In other circumstances, for example extending credit to purchasers of the Company's products, the Board has delegated responsibility for credit assessment to management, but receives frequent financial and operating reports.

The Company's financial instruments recognized on the audited consolidated balance sheets at December 31, 2008 and 2007 consist of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying amounts based on the short term nature of these instruments.

a) Credit risk: A substantial portion of the Company's accounts receivable are concentrated with a limited number of purchasers of commodities and joint interest partners in the oil and gas industry and are subject to normal industry credit risk. Management considers these concentrations of credit risk to be minimal, as commodity purchasers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. Receivables related to the sale of the Company's production are normally collected on the 25th day of the month following delivery. The Company has not experienced any credit loss in the collection of its accounts receivable.

As at December 31, 2008, the accounts receivable was comprised of the following:

($000)		
Sales revenue accounts receivable	$	1,909
Joint interest accounts receivable		3,660
Cash call accounts receivable		-
Accrued and other accounts receivable		254
Total accounts receivable	$	5,823

The carrying amounts of cash, cash equivalents, and accounts receivable represent the Company's maximum credit exposure. The Company has no allowance for doubtful accounts as at December 31, 2008. As at December 31, 2008 the Company estimates its trade accounts receivable to be aged as follows:

Aging *($000)*		
Not past due (less than 30 days)	$	5,291
Past due 31-60 days		237
Past due 61-90 days		158
Past due more than 90 days		137
Total	$	5,823

Year ended December 31, 2008 and period ended December 31, 2007

a) Market risk: Market risks are as follows and are largely outside of the control of the Company:

Commodity Prices

The Company is constantly exposed to the risk of declining prices for its products with a corresponding reduction in cash flow. Reduced cash flow may result in lower levels of capital being available for field activity, thus compromising the Company's capacity to grow production while at the same time replacing continuous declines from existing properties. In certain circumstances, usually when debt levels are forecast to increase due to capital expenditures exceeding cash flow, or where the Company has financed, in whole or in part, an acquisition using bank debt, the Company may enter into oil and natural gas hedging contracts in order to provide stability to future cash flow. These contracts reduce the fluctuation in production revenue by fixing prices of future deliveries of oil and natural gas. At December 31, 2008, the Company had no fixed price contracts or financial instruments associated with future production.

For the year ended December 31, 2008, if oil prices had been US$1 per barrel lower, with all other variables held constant, after tax net earnings for the year would have been $123,000 lower (assuming production of 141,000 bbls of crude oil). An equal and opposite impact would have occurred to net earnings had oil prices been US$1 per barrel higher.

For the year ended December 31, 2008, if gas prices had been US$1 per mcf lower, with all other variables held constant, after tax net earnings for the year would have been $711,000 lower (assuming production of 787,000 mcf of gas). An equal and opposite impact would have occurred to net earnings had gas prices been US$1 per mcf higher.

Interest Rates

Interest on the Company's revolving bank facility varies, and is most commonly based on the lender's prime rate. The Company is thus exposed to increased borrowing costs during periods of increasing interest rates, with a corresponding reduction in both cash flows and project economics. The Company had no bank debt at December 31, 2008 and have had no interest rate swaps or similar contracts. The Company invests available cash in short-term term deposits from which interest income will vary with changes in prime rates.

For the year ended December 31, 2008, if interest rates had been 1% lower than the 2008 weighted average rate of 3.2%, with all other variables held constant, after tax net earnings for the period would have been $260,000 lower, due to lower interest income. An equal and opposite impact would have occurred to net earnings had interest rates been 1% higher.

Foreign Exchange

Although the Company's product revenues are denominated in Canadian dollars, the underlying market prices are affected by the exchange rate between the Canadian and the United States dollar. As at December 31, 2008, the Company had no contracts in place to manage foreign exchange risk.

Liquidity Risk

Liquidity difficulties would emerge if the Company was unable to meet its financial obligations as they fell due within normal credit terms. This may be the consequence of diminished cash flows resulting from lower product prices, production interruptions, or unexpected operating or capital cost increases. Liquidity difficulties could also occur if the Company's bankers were unable to continue to provide credit at a level and on terms compatible with the Company's capital requirements. Generally the Company will, over a reasonable period of time, limit its capital programs to funds flow from operations, available cash, and available credit. In addition, the Company endeavors to maintain its debt at a level to ensure financial flexibility to deal with unforeseen or rapidly changing circumstances.

Corporate Information

BOARD OF DIRECTORS

Ronald R. Talbot, Chairman
President
557146 Alberta Inc.
Calgary, Alberta

Kevin Angus
Executive Vice President & Director
Pegasus Oil & Gas Inc.
Calgary, Alberta

Allan K. Ashton
President
Ashton Petroleum Consultants
Priddis, Alberta

Glenn R. Carley
Executive Chairman & Director
Galleon Energy Inc.
Calgary, Alberta

Arthur J. G. Madden
President
554492 Alberta Ltd.
Edmonton, Alberta

Patrick R. Ward
President & Chief Executive Officer
Painted Pony Petroleum Ltd.
Calgary, Alberta

OFFICERS

Patrick R. Ward
President & Chief Executive Officer

Joan E. Dunne
Vice President, Finance & Chief Financial Officer

James H. French
Vice President, Engineering

Bruce M. Mezei
Vice President, Geology

James S. Thomson
Vice President, Land

Donald J. Slater
Vice President, Geophysics

Mary Kay Axford
Controller

Douglas McCartney
Partner, Burstall Winger LLP
Corporate Secretary

EXCHANGE LISTING

TSX Venture Exchange
Trading symbols:
Class A Shares: PPY.A
Class B Shares: PPY.B

LEGAL COUNSEL

Burstall Winger LLP

AUDITORS

KPMG LLP

BANKERS

National Bank of Canada

EVALUATION ENGINEERS

Sproule Associates Limited

REGISTRAR AND TRANSFER AGENT

Olympia Trust Company
Calgary, Alberta
1 800 727-4493
Enquiries:
cssinquiries@olympiatrust.com

HEAD OFFICE

300, 602 - 12 Ave SW
Calgary, Alberta T2R 1J3
Phone: (403) 475-0440
Fax: (403) 238-1487
Toll Free Investor: 1 (866) 975-0440
Email: info@paintedpony.ca
www.paintedpony.ca

PAINTED PONY
PETROLEUM LTD.

300, 602 - 12 Ave SW Calgary, Alberta T2R 1J3

Phone: (403) 475-0440 Fax: (403) 238-1487

Toll Free: 1-866-975-0440

www.paintedpony.ca